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IN THE MATTER OF THE CONSIDERATION
PURSUANT TO A.R.S. § 40-252, TO
MODIFY DECISION NO. 67744 RELATING
TO THE SELF-BUILD OPTION.

Docket No. E-01345A-07-0420

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the
Direct Testimony of Stephen Ahearn in the above-referenced matter.

RESPECTFULLY SUBMITTED this 11th day of January 2008

[Signature]
Scott S. Wakefield
Chief Counsel

AN ORIGINAL AND THIRTEEN COPIES
of the foregoing filed this 11th day
of January 2008 with:

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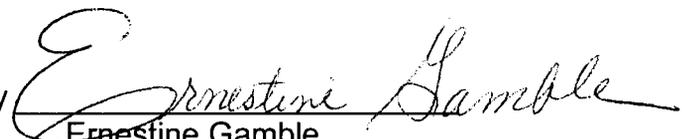
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By 
Ernestine Gamble
Secretary to Scott Wakefield

ARIZONA PUBLIC SERVICE COMPANY

DOCKET NO. E-01345A-07-0420

DIRECT TESTIMONY

OF

STEPHEN AHEARN

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JANUARY 11, 2008

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1 **INTRODUCTION**

2 Q. Please state your name and business address for the record.

3 A. My name is Stephen Ahearn. My business address is 1110 West Washington,
4 Suite 220, Phoenix, Arizona 85007.

5
6 Q. Please state your educational background and qualifications in the utility
7 regulation field.

8 A. I have been employed by the state of Arizona as the Director of the Residential
9 Utility Consumer Office ("RUCO") since January 2003. From 1998 through 1999,
10 I was employed at the Arizona Corporation Commission in the capacity of
11 Executive Consultant. From 1990 to 1998, I was actively involved with utility
12 regulation at the Commission and utility policy-making at the Legislature in my
13 role as the Manager of Planning and Policy at the Department of Commerce
14 Energy Office. Additionally, I have had training in utility ratemaking and
15 telecommunications policy conducted by NARUC and New Mexico State
16 University, respectively. Finally, I have an MBA in Finance from UCLA.

17
18 **BACKGROUND**

19 Q. What is the self-build option of Decision No. 67744 to which the caption of this
20 docket refers?

21 A. The Commission's Decision No. 67744 adopted, with modifications, a Settlement
22 Agreement regarding a 2003 rate application by Arizona Public Service Company
23 ("APS"). The Settlement Agreement included a partial restriction on APS putting

1 into service any self-built generation prior to January 1, 2015 without the prior
2 approval of the Commission (the "Self-Build Moratorium").¹ The Settlement
3 Agreement outlined what APS was to include in any application for such
4 authorization to self-build,² and indicated that certain acquisitions by APS would
5 not be considered "self-build" for purposes of the restriction.³

6
7 Q. Why was the Self-Build Moratorium adopted?

8 A. The Settlement Agreement also included a term whereby APS was permitted to
9 include in its rate base, at a significant discount from their construction costs,
10 generation facilities that had been constructed by its affiliate Pinnacle West
11 Energy Corporation ("PWEC").⁴ According to Decision No. 67744, the Self-Build
12 Moratorium was designed to address the potential anti-competitive effects that
13 could be associated with including the PWEC assets in APS' rate base.⁵

14
15 Q. Was the Self-Build Moratorium meant to be an absolute ban on APS constructing
16 its own generation facilities through 2014?

17 A. No. First, as I noted above, there were a number of relatively narrow types of
18 resources that were specifically excluded from the Moratorium (e.g., temporary
19 resources for system reliability, renewable resources).⁶ Second, the Settlement
20 Agreement explicitly permitted APS to seek exceptions to the Moratorium. In

¹ Decision No. 67744, Settlement Agreement at ¶ 74.

² *Id.* at ¶ 75.

³ *Id.* at ¶ 74. In adopting the Settlement Agreement, the Commission narrowed this exception slightly. See Decision No. 67744 at 25.

⁴ Decision No. 67744, Settlement Agreement at ¶¶ 6, 7.

⁵ Decision No. 67744 at 25.

⁶ Decision No. 67744 at 25 and Settlement Agreement at ¶ 74.

1 the event the wholesale market did not develop adequately and that APS
2 therefore wasn't able to meet its resource needs cost-effectively from that
3 market, APS was given the opportunity to build its own generation resources.⁷
4 Prior to any such efforts to self-build, however, APS was required to demonstrate
5 to the Commission that the wholesale market had in fact failed to produce
6 resources that were cost-effective when compared with APS' costs to self-build.
7 The Settlement Agreement explicitly stated that the Moratorium "shall not be
8 construed as relieving APS of its existing obligation to prudently acquire
9 generating resources," including seeking the permitted authorization to self-
10 build.⁸

11
12 Q. Has APS sought authorization from the Commission to build generation assets
13 when the competitive market was not able to produce a more cost-effective
14 alternative?

15 A. Yes it has, and the Commission approved APS' application to do so. In Docket
16 No. E-01345A-06-0464, APS sought Commission approval to purchase a new
17 generation resource in APS' Yuma load pocket. The Commission held a hearing
18 in January 2007 and granted approval of APS' request in Decision No. 69400
19 (March 30, 2007). While the Commission did hold four days of hearing in that
20 proceeding, it indicated in its Decision that an evidentiary hearing may not be
21 necessary for every application for authority to self-build, and the Commission

⁷ See my Direct Testimony in support of the Settlement Agreement, filed September 27, 2004, at
pg. 7, Docket No. E-01345A-03-0437.

⁸ Decision No. 67744, Settlement Agreement at ¶ 76.

1 declined to impose specific procedural requirements for any future disputes
2 regarding the requirements of the Settlement Agreement related to self-building
3 of generation.⁹

4
5 Q. Why is the Commission now considering whether to modify the self-build
6 provisions of Decision No. 67744?

7 A. In 2005, after the Commission approved the Settlement Agreement in Decision
8 No. 67744, APS filed another rate application. That application went to hearing
9 in the Fall of 2006. While that hearing was underway, Commissioner Hatch-
10 Miller issued a letter in that proceeding expressing concern that, because of the
11 Self-Build Moratorium, APS may face challenges in procuring additional power
12 supplies and that volatile natural gas prices and potential gas supply and delivery
13 constraints might make competitive procurement problematic.¹⁰

14
15 Between the conclusion of the 2005 rate case hearing in December 2006 and the
16 Open Meeting to resolve it in June 2007, the Commission heard the Yuma self-
17 build application and adopted Decision No. 69400. At the Open Meeting on the
18 2005 rate case the Commission discussed an amendment to the Recommended
19 Opinion and Order that would have streamlined the procedure by which APS
20 could seek an exception to the Self-Build Moratorium. Ultimately, the
21 Commission instead adopted an amendment that required its Hearing Division to
22 initiate this proceeding. On its face Decision No. 69663 merely orders the

⁹ Decision No. 69400 at 18.

¹⁰ October 24, 2006 Letter from Commissioner Hatch-Miller in Docket No. E-01345A-05-0816 *et al.*

1 Hearing Division to conduct a proceeding pursuant to A.R.S. § 40-252 to
2 consider modifying Decision No. 67744 relating to the self-build option, but the
3 Decision says nothing about why the Commission is requiring the proceeding.
4 Based on the Commissioners' discussion that led to the amendment, however, it
5 appears that the Commission envisions this proceeding as potentially involving
6 more than just streamlining the process by which APS can seek an exemption
7 from the Self-Build Moratorium.

8
9 **RUCO IS NOT PROPOSING MODIFICATIONS**

10 Q. Does RUCO believe that the Self-Build Moratorium needs to be modified?

11 A. No. RUCO is not proposing any modifications to the Moratorium. I believe that
12 the Settlement Agreement and Decision No. 67744 established an appropriate
13 balance between reliance on the wholesale electric market and requiring APS to
14 meet its load by using the most cost-effective resource—regardless of who owns
15 those resources. RUCO strongly supports the Commission's statement in
16 Decision No. 69400 that APS must be permitted to pursue self-building
17 generation resources if that is the most prudent option.¹¹ I believe that the
18 obligation that APS has to seek an exemption from the Self-Build Moratorium if
19 reasonably priced resources are not available in the wholesale market is the key
20 aspect of the Settlement Agreement that makes the Self-Build Moratorium, as a
21 whole, appropriate.

22

¹¹ See Decision No. 69400 at 17-18.

1 Since I don't know what other parties might be proposing in their testimony filed
2 concurrently with mine, I will reserve judgment on any proposals others make
3 until I see them, and I will offer any necessary response to them in my rebuttal
4 testimony.

5

6 Q. Does this conclude your testimony?

7 A. Yes.