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LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW

P. O. Box 1448
TUBAC, ARIZONA 85646

(520) 398-0411
FAX: (520) 398-0412
EMAIL: TUBACLAWYER@AOL.COM

ADMITTED TO PRACTICE IN:
ARIZONA, COLORADO, MONTANA,
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DISTRICT OF COLUMBIA

OF COUNSEL TO
MUNGER CHADWICK, P.L.C.

February 29, 2008

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ARIZONA CORP. COMM
400 W CONGRESS STE 218 TUCSON AZ 85701

Docket Control
Arizona Corporation Commission
C/O 400 West Congress, Suite 218
Tucson, Arizona 85701

Re: Tucson Electric Power Company
Docket Nos. E-01933A-07-0402 and
E-01933A-05-0650

To Whom It May Concern:

Enclosed for filing in the above-referenced proceedings on behalf of Mesquite Power, L.L.C., Southwestern Power Group II, L.L.C., Bowie Power Station, L.L.C. and Sempra Energy Solutions LLC are the original and fifteen (15) copies of the Prepared Direct Testimony Of Leesa Nayudu. In that regard, please note that 2 (two) additional copies have been enclosed to meet the requirement of additional copies for additional docket numbers. In addition, both docket numbers have been noted on the lower right hand corner of the cover sheet of the original and each copy of the aforesaid testimony.

Thank you for your assistance with regard to this matter.

Arizona Corporation Commission
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MAR 4 2008

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Sincerely,

Lawrence V. Robertson, Jr.

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**PREPARED DIRECT TESTIMONY
OF
LEESA NAYUDU**

LAWRENCE V. ROBERTSON, JR.
ATTORNEY AT LAW
P.O. Box 1448
Tubac, Arizona 85646
(520) 398-0411

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MESQUITE POWER LLC. et al.
DOCKET NO. E-01933A-07-0402
DOCKET NO. E-01933A-05-0650
February 29, 2008.

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**Prepared Direct Testimony
Of
Leesa Nayudu**

Q.1 Please state your name and business affiliation.

A.1 My name is Leesa Nayudu, and I am Regional Director Of Operations (West) for Sempra Generation.

Q.2 On whose behalf are you providing this testimony?

A.2 I am testifying on behalf of Mesquite Power, L.L.C., Southwestern Power Group II, L.L.C., Bowie Power Station, L.L.C. and Sempra Energy Solutions LLC, (collectively "Mesquite et al."). Mesquite et al. were granted intervention in this proceeding by means of a Procedural Order issued on September 13, 2007.

Q.3 What is the purpose of your testimony?

A.3 Mesquite et al. have certain issues they wish to address at this time, either (i) for the purpose of indicating what their position is with regard to the same, or (ii) for the purpose of indicating that they desire more information and/or a better understanding as to what TEP is proposing. With respect to the latter, hopefully TEP will provide that information and/or understanding in testimony it will be filing at a later stage in this proceeding.

Q.4 Do Mesquite et al. have a position on TEP's contention that, pursuant to the provisions of the 1999 Settlement Agreement, TEP is entitled to charge market-based rates after January 1, 2009?

A.4 No, we do not. Representatives of Mesquite et al. were not involved in the negotiations which resulted in TEP's 1999 Settlement Agreement, nor did they participate in the

1 hearings before the Commission which resulted in Decision No. 62103. Hence, it would
2 be presumptuous of Mesquite et al. to opine as to what the signatory parties to the 1999
3 Settlement Agreement and/or the Commission may have intended with respect to how
4 TEP's rates were to be established for service provided by TEP on and after January 1,
5 2009.

6
7 **Q.5 With reference to the "regulatory asset(s)" proposed by TEP in connection with its**
8 **"Cost-of-Service Methodology" and its "Hybrid Methodology," do Mesquite et al.**
9 **have a position?**

10 A.5 Not as of this stage in this proceeding. Depending on the evidentiary record yet to be
11 developed through the hearing process, our current lack of a position on this issue might
12 change, and then again it might not.

13
14 **Q.6 Do Mesquite et al. have a position on the Purchase Power and Fuel Adjustment**
15 **Clause ("PPFAC") which TEP has proposed in connection with its "Cost-of-Service**
16 **Methodology" and its "Hybrid Methodology"?**

17 A.6 Yes. From a conceptual perspective, Mesquite et al. support a PPFAC for TEP, provided
18 that in connection with purchased power and fuel expense(s) to be recovered thereunder,
19 TEP would be required to demonstrate its ongoing compliance with the Recommended
20 Best Practices For Procurement adopted by the Commission on December 4, 2007 in
21 Decision No. 70032. We do not believe that TEP should be allowed rate recovery for
22 purchased power and fuel expense(s) where it cannot demonstrate compliance with the
23 Commission's Recommended Best Practices For Procurement.

24
25 **Q.7 Assuming such compliance by TEP, why do Mesquite et al. believe that a PPFAC**
26 **would be appropriate for TEP?**

27 A.7 As TEP witness David Hutchens has noted in his July 2, 2007 Direct Testimony
28

1 “TEP relies on significant quantities of natural gas and purchased power
2 to meet its retail load. Although TEP has served the majority of its load
3 with company-owned generating resources, it relies on natural gas and
4 purchased power to meet a growing percentage of its customer demand.
5 This gas and power is purchased at market prices, so TEP should be
6 allowed to recover these costs. The PPFAC is designed to recover or
7 return the difference between the actual cost of natural gas and the
8 purchased power versus the cost of natural gas and purchased power
9 established in base rates.

10 “TEP is concerned about the volatile fuel and energy markets causing
11 large deferrals of uncollected costs. Without an adjustor mechanism
12 to timely address these costs in a way that sends accurate price signals to
13 customers, the Company could incur substantial deferrals that could affect
14 its ability to secure financing on favorable terms. It also could affect the
15 Company’s ability to secure natural gas and purchase power in the future
16 on terms as favorable to the Company and its customers. In fact, the
17 Company could face credit terms that could hurt its ability to secure
18 reasonably priced fuel and purchase power in the future by requiring
19 credit enhancements such as repayment or letters of credit. This could
20 lead to the inability to hedge future prices or enter into long term resource
21 or contract commitments and being forced to rely heavily on the volatile
22 short-term and spot markets.” [Hutchens Direct Testimony, page 30, line
23 18 – page 31, line 11] [emphasis added]

24 As sellers in the competitive wholesale electric power market in Arizona, Mesquite et al.
25 can attest to the importance of TEP being considered a creditworthy purchaser, and the
26 problems Mr. Hutchens has indicated TEP might encounter without some form of
27 Commission – approved adjustor mechanism, such as a PPFAC.

28 In addition, as TEP witness Judah Rose notes at pages 36-37 of his July 2, 2007 Direct
Testimony, the competitive wholesale electric power market in Arizona has become quite
robust and large in relation to TEP’s power resource needs. Thus, it would be
unfortunate for TEP and its ratepayers if the absence of an adjustor mechanism precluded
it from obtaining power on favorable terms and conditions that the competitive market
might otherwise offer.

1 **Q.8 Do Mesquite et al. have a position with respect to TEP's proposed restoration of the**
2 **exclusivity of its CC&N under both its "Cost-of-Service Methodology" and its**
3 **"Hybrid Methodology"?**

4 A.8 Yes, we are opposed to TEP's proposed restoration in each instance. In that regard, the
5 reasoning of TEP witness James S. Pignatelli in support of TEP's restoration proposal is
6 worth noting, because of the flawed "linkage" it assumes between cost-of-service
7 ratemaking and the assumed absence of the prospect of retail electric competition:

8 "...if the Commission adopts the Cost-of-Service Methodology, then it
9 will have abandoned retail electric competition for TEP's customers. In
10 that case, TEP should have the right to exclusively provide electric service
11 within its certificate area. To ensure that TEP has the exclusive right to
12 provide electric service, the Commission should order that its exclusive
13 CC&N is restored. Additionally, under the Hybrid Methodology, where a
14 majority of TEP's generation would be returned to cost-of-service
15 ratemaking, it is also appropriate to partially restore the exclusivity of
16 TEP's CC&N." [Pignatelli Direct, page 22, lines 18 - 25] [emphasis
17 added]

18 There is no direct linkage of this nature in Arizona as this time. Cost-of-service
19 regulation and the Commission's Electric Competition Rules exist quite separate from
20 one another; and, unless and until the Commission rescinds the Electric Competition
21 Rules, it cannot be said that the Commission has "abandoned retail electric competition."
22 In that regard, the flaw in TEP's reasoning exists in both its proposed complete
23 restoration of exclusivity under the "Cost-of-Service Methodology" and its proposed
24 partial restoration of exclusivity under the "Hybrid Methodology." Moreover, in the last
25 two (2) Arizona Public Service Company ("APS") rate cases, the Commission has
26 approved both bundled and unbundled rates for APS, and left its service open to retail
27 electric competition; and, TEP has proposed unbundled rates for each of its three (3)
28 ratemaking methodologies in this proceeding.

Q.9 What is the position of Mesquite et al. with regard to TEP's proposal to exclude its
ownership interest in the Four Corners and Navajo generating stations from TEP's

1 **rate base, and classify those power resources as “Competitive Assets,” which could**
2 **either compete in the competitive wholesale market or sell power to TEP at market-**
3 **based rates?**

4 A.9 Before taking a position on this aspect of TEP’s “Hybrid Methodology,” Mesquite et al.
5 need a better understanding as to (i) how these “Competitive Assets” would be interfaced
6 with and participate in the competitive wholesale market, and (ii) under what
7 circumstances TEP would be allowed to choose to buy power from its “Competitive
8 Assets” at market-based rates. In that regard, Mesquite et al. need to know how and to
9 what extent the Recommended Best Practices For Procurement will apply to and affect
10 this aspect of the “Hybrid Methodology.” Stated differently, we need to know how the
11 existence of the “Competitive Assets” would affect when and the extent to which TEP
12 would look to the competitive wholesale market, as contrasted with the situation under its
13 “Cost-Of-Service-Methodology” where TEP would have no “Competitive Assets.”
14 Perhaps TEP will provide information on this subject in its forthcoming Rebuttal
15 Testimony.

16
17 **Q.10 Are there any other aspects of the “Hybrid Methodology” with regard to which**
18 **Mesquite et al. would like more information and clarification from TEP?**

19 A.10 Yes. Despite having reviewed the Direct Testimony of Messrs. Pignatelli and Hutchens,
20 where they discuss the nature of and reasoning underlying the “Hybrid Methodology,” it
21 is not clear why TEP has proposed this alternative approach to ratemaking, given their
22 testimony elsewhere as to TEP’s need to substantially augment company-owned
23 generation in the future. On the face of it, one would think TEP would want to retain
24 within its rate base power generation resources that still have a useful operating life.
25 Accordingly, before adopting a position on the “Hybrid Methodology,” Mesquite et al.
26 would like more information on this aspect of the proposal as well. Perhaps TEP can
27 include such information and clarification in its forthcoming Rebuttal Testimony.

1 **Q.11 Are there any other aspects of TEP's July 2, 2007 Application on which Mesquite et**
2 **al. would like more information and clarification?**

3 A.11 Yes. It is as yet unclear to us why TEP appears to be proposing to recover most, if not
4 all, of its costs of operating the Luna generating facility through the PPFAC, yet, if we
5 understand the situation correctly, it would include the Luna generating facility in its rate
6 base under both the "Cost-of-Service Methodology" and the "Hybrid Methodology."
7 Under those two (2) scenarios, one would anticipate adjusted test period operating costs
8 associated with Luna would be included in TEP's proposed base rates. Accordingly, any
9 further information or clarification TEP could provide on this subject in its forthcoming
10 Rebuttal Testimony would also be appreciated. Once we have that information,
11 Mesquite et al. can then determine if they have a position on this proposal.

12
13 **Q.12 Are there any other aspects of TEP's Application that you would like to comment**
14 **upon?**

15 A.12 Not at this time. After we have reviewed TEP's Rebuttal Testimony, Mesquite et al. may
16 have occasion to file additional testimony in accordance with the Procedural Schedule
17 which has been established by Administrative Law Judge Rodda. In addition, we may
18 explore some of these matters in greater detail through cross-examination during the
19 hearing to be held on TEP's Application, as well as other issues which may arise.

20
21 **Q.13 Does that complete your Direct Testimony?**

22 A.13 Yes, it does.
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