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BEFORE THE ARIZONA CORPORATION

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GARY PIERCE

JUN 10 2008

AZ CORP COMMISSION
DOCKET CONTROL

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

IN THE MATTER OF THE APPLICATION OF) DOCKET NO. E-01933A-07-0402
TUCSON ELECTRIC POWER COMPANY FOR)
THE ESTABLISHMENT OF JUST AND)
REASONABLE RATES AND CHARGES)
DESIGNED TO REALIZE A REASONABLE)
RATE OF RETURN ON THE FAIR VALUE OF)
ITS OPERATIONS THROUGHOUT THE STATE)
OF ARIZONA.)

IN THE MATTER OF THE FILING BY) DOCKET NO. E-01933A-05-0650
TUCSON ELECTRIC POWER COMPANY TO)
AMEND DECISION NO. 62103.)

TESTIMONY OF LEESA NAYUDU AND GREG BASS 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.")

Arizona Corporation Commission
DOCKETED

JUN 12 2008

DOCKETED BY: NK

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**PREPARED DIRECT TESTIMONY
OF
LEESA NAYUDU AND GREG BASS**

Q.1 Please state your names and business affiliations.

A.1 My name is Leesa Nayudu, and I am Director of Origination with Sempra Generation, which owns Mesquite Power, L.L.C. ("Mesquite"). My name is Greg Bass, and I am Director of Retail Commodity Operations with Sempra Energy Solutions LLC ("SES").

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

A.2 We are testifying on behalf of Mesquite, Southwestern Power Group II, L.L.C., Bowie Power Station, L.L.C. and SES, (collectively "Mesquite et al."). Leesa Nayudu is the sponsoring witness for those portions of the Direct Testimony which pertain to subjects other than retail electric competition and direct access; and Greg Bass is the sponsoring witness as to retail electric competition and direct access matters. Mesquite et al. were granted intervention in this proceeding by means of a Procedural Order issued on September 13, 2007. Thereafter, we filed Prepared Direct Testimony on February 29, 2008; and, we were active participants in the settlement negotiations which resulted in the May 29, 2008 Settlement Agreement that was filed with the Commission that same day.

Q.3 What is the purpose of your testimony at this time?

A.3 Each of the companies comprising Mesquite et al. has signed the Settlement Agreement. Pursuant to the Procedural Order issued by the Administrative Law Judge Jane Rodda on May 12, 2008, Mesquite et al. are providing this Direct Testimony in support of the Settlement Agreement as it relates to their collective interests.

Q.4 Please identify those areas of the Settlement Agreement which you will address in your testimony.

1 A.4 We will be discussing certain portions of Sections I (Rate Increase), II (Ratemaking
2 Treatment of TEP's Generating Assets and Fuel Costs), VII (Purchased Power and Fuel
3 Adjustment Clause), XII (Certificate of Convenience and Necessity) and XIII (Returning
4 Customer Direct Access Charge).

5
6 **Q.5 What is the position of Mesquite et al. with regard to the proposed rate increase in
7 base rates for TEP set forth in Section II?**

8 A.5 As indicated in the Direct Testimony we filed on February 29, 2008, Mesquite et al.
9 believe it is important that TEP be allowed an opportunity to receive revenues sufficient
10 to allow it to be a creditworthy purchaser in the competitive wholesale market in Arizona.
11 We ourselves do not presume to know what level of increase in base rates will allow TEP
12 to retain that status. However, given TEP's stated intent to obtain a significant portion of
13 its future power resource requirements from the competitive wholesale electric power
14 market, and TEP's acceptance of the proposed increase over average base rates of
15 approximately six percent (6%), it is reasonable to assume that TEP has determined that
16 such an increase will enable it to retain the requisite creditworthiness. We therefore
17 support TEP's acceptance of the rate increase contained in the Settlement.

18
19 **Q.6 Does Mesquite et al. believe that the inclusion of TEP's generation assets provided
20 for in Section III is appropriate?**

21 A.6 Yes. Given that TEP has agreed that cost-of-service ratemaking shall be used for
22 purposes of these proceedings, Mesquite et al. believe that all of TEP's generating assets
23 should be included in its rate base at original cost for ratemaking purposes as provided
24 for in Section 3.1.

25
26 **Q.7 In that regard, does that mean that you anticipate that TEP will have little occasion
27 to look to the competitive wholesale electric power market in the future, since
28**

1 **Section 3.1 includes generation assets acquired by TEP after December 31, 2006, but**
2 **before December 31, 2012?**

3 A.7 No, not at all. In fact the last sentence in Section 3.1 expressly states that

4 “This provision is not intended to create a presumption in favor of
5 [company-owned] generation, and the Signatories acknowledge
6 that TEP is obligated to consider all reasonable alternatives when
7 evaluating how to meet its service obligations to its customers.”

8 Against that background, as well as the Recommended Best Practices For Procurement
9 adopted by the Commission on December 4, 2007 in Decision No. 70032, Mesquite et al.
10 anticipate that TEP will be an active participant in the competitive wholesale electric
11 power market in Arizona in the future.

12 **Q.8 Do Mesquite et al. support the proposed Purchased Power and Fuel Adjustment**
13 **Clause (“PPFAC”) which is the subject of Section VII?**

14 A.8 Yes, for two (2) reasons. First, we believe that the existence of the proposed PPFAC will
15 enable TEP to remain a creditworthy purchaser within the competitive wholesale electric
16 power market in Arizona. However, as stated in our February 29, 2008 Direct
17 Testimony, Mesquite et al.’s support in this regard is conditioned upon TEP being
18 required to demonstrate its ongoing compliance with the Recommended Best Practices
19 For Procurement in connection with purchased power and fuel expense TEP would seek
20 to recover through the PPFAC.

21 Second, and in relation to the foregoing condition, Mesquite et al. believe that the
22 provisions of the Proposed Plan of Administration (“POA”) for the PPFAC, as attached
23 to the Settlement Agreement, provide for that transparency and access to information
24 necessary to insure that TEP can be required to demonstrate, if necessary, its ongoing
25 compliance with the Recommended Best Practices For Procurement. In that regard, at
26 the forthcoming hearing on the proposed Settlement Agreement, Mesquite et al.’s counsel
27 will inquire of the appropriate TEP witness as to whether TEP intends to interpret and
28 administer its “company procurement protocols,” as referenced in Section 8 [page 8] of

1 the POA, so as to comply with the Recommended Best Practices For Procurement. For
2 purposes of this Direct Testimony in support of the proposed PPFAC, Mesquite et al.
3 assume that the answer to that question will be in the affirmative.
4

5 **Q.9 In their February 29, 2008 Direct Testimony, Mesquite et al. opposed TEP's**
6 **proposed restoration of the exclusivity of its CC&N, in the event that the cost-of-**
7 **service ratemaking methodology was used to determine TEP's post-January 1, 2009**
8 **rates. Are Mesquite et al. satisfied with how Section XII resolves this issue; and, if**
9 **so, why?**

10 A.9 Mesquite et al. are satisfied with the resolution approach reflected in Section XII, because
11 it in essence preserves the "status quo" with respect to the status of retail electric
12 competition in Arizona. More specifically, Mesquite et al. believe that retail electric
13 competition in Arizona has not been foreclosed because of the Arizona Court of Appeals
14 decision in the Phelps Dodge case, and that the Commission possesses the jurisdiction
15 and authority to proceed with retail electric competition at this time if it desires to do so.
16 At the same time, we recognize that TEP and others may not share that view. It is our
17 belief that, if the Commission has any question as to its jurisdiction and authority to
18 proceed with retail competition in the aftermath of the Phelps Dodge decision, it could
19 resolve that question within the context of a generic proceeding of general applicability,
20 and that it should not resolve it within the context of a rate case specific to a single utility.

21 In this regard, several months ago in a proceeding involving an Application by
22 Sempra Energy Solutions LLC ("SES") for an Electric Service Provider CC&N to
23 provide competitive retail electric service in the certificated service areas of TEP,
24 Arizona Public Service Company ("APS") and Salt River Project, counsel for SES
25 presented detailed legal argument as to why the Commission currently has the necessary
26 jurisdiction and authority to act upon SES' CC&N request. The Administrative Law
27 Judge assigned to the SES proceeding [Docket No. E-03964A-06-0168] has yet to issue a
28 ruling as to whether that proceeding can go forward at this time. Thus, the status of

1 electric retail competition in Arizona remains open at this time, and Section XII
2 recognizes and preserves that status.

3
4 **Q.10 In what manner do the provisions of Section XII preserve the “status quo” of retail**
5 **competition?**

6 A.10 First, TEP’s proposed restoration of the exclusivity of its CC&N is removed from the
7 scope of issues to be resolved through this proceeding. If the Commission desires to
8 address that question at all, Section 12.1 provides that it would do so in a “generic
9 docket,” but it does not presume that the Commission believes there is a need to conduct
10 such a proceeding.

11 Second, Section 12.2 recognizes TEP’s obligation to recognize

12 “the existence of any Commission direct access program and the
13 potential for future direct access customers”

14 as a part of TEP’s ongoing planning activities. In so doing, it does not expressly assume
15 anything with regard to the status of any such program. Whereas, under TEP’s originally
16 proposed restoration of the exclusivity of its CC&N, the existence of any direct access
17 program and the potential for future direct access customers would automatically have
18 been foreclosed.

19 Third, Section 12.3 provides that

20 “This Agreement is not intended to create, confirm, diminish or
21 expand an exclusive right for TEP to provide electric service
22 within its certificated area where others may legally also provide
23 such service...”

24 Simply stated, the Settlement Agreement does not disturb the legal status of retail electric
25 competition in Arizona, whatever that status may be.

26 Thus, for these reasons, Mesquite et al. believe that Section XII represents an appropriate
27 resolution.

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Q.11 Is Section XIII relevant to what you have been discussing with respect to Section XII; and, if so, in what manner?

A.11 Section XIII provides that TEP will file a Returning Customer Direct Access Charge (“RCDAC”) tariff within ninety (90) days of the effective date of the Commission’s order approving the Settlement Agreement. The mere existence of such a tariff presupposes the possibility of direct access customers, and the possible existence of retail electric competition concurrent with the use of a cost-of-service methodology for ratemaking for the incumbent electric utility. This approach is consistent with the preservation of the “status quo” approach reflected in Section XII, which has been previously discussed. In addition, it is conceptually consistent in this regard with the tariff system utilized by APS.

Q.12 Is the subject and status of retail electric competition a matter of interest only for SES, as opposed to the entirety of Mesquite et al.?

A.12 Not at all. By definition, a direct access customer is one who will be receiving its power supply from someone other than the incumbent electric utility, which in this instance would be TEP. Thus, the direct access market occasioned by the existence of retail electric competition is of interest to independent power producers or merchant generators, just as is the market represented by incumbent electric utilities, such as TEP.

Q.13 Does that complete Mesquite et al.’s Direct Testimony in support of the proposed Settlement Agreement?

A.13 Yes, it does.