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

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

June 29, 2009

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Arizona Corporation Commission
DOCKETED

JUN 29 2009

DOCKETED BY 

Re: Arizona Public Service Company
Docket No. E-01345A-08-0172

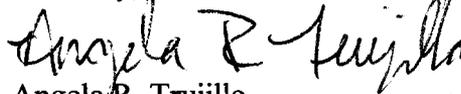
To Whom It May Concern:

Pursuant to the May 11, 2009 Procedural Order in the above-referenced proceeding, enclosed for filing are the original and thirteen (13) copies of Direct Testimony of Leesa Nayudu ("Testimony") on behalf of Mesquite Power, L.L.C., Southwestern Power Group II, L.L.C. and Bowie Power Station, L.L.C.

Also enclosed are two (2) additional copies of the Testimony. I would appreciate it if you would "filed" stamp the same and return them to me in the enclosed stamped and addressed envelope.

Thank you in advance for your assistance. Please advise me if you have any questions.

Sincerely,



Angela R. Trujillo
Secretary
Lawrence V. Robertson, Jr.

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COMMISSIONERS

KRISTIN K. MAYES, Chairman
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PAUL NEWMAN
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2009 JUN 30 P 12: 26

ARIZONA CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION OF)
ARIZONA PUBLIC SERVICE COMPANY FOR)
A HEARING TO DETERMINE THE FAIR)
VALUE OF THE UTILITY PROPERTY OF THE)
COMPANY FOR RATEMAKING PURPOSES,)
TO FIX A JUST AND REASONABLE RATE OF)
RETURN THEREON, TO APPROVE RATE)
SCHEDULES DESIGNED TO DEVELOP SUCH)
RETURN)

DOCKET NO. E-01345A-08-0172

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**DIRECT TESTIMONY OF LEESA NAYUDU ON BEHALF OF
MESQUITE POWER, L.L.C., SOUTHWESTERN POWER GROUP II, L.L.C.,
AND BOWIE POWER STATION, L.L.C. ("COLLECTIVELY "MESQUITE GROUP")**

**DIRECT TESTIMONY
OF
LEESA NAYUDU**

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Q.1 Please state your name and business affiliation.

A.1 My name is Leesa Nayudu, and I am Director of Origination with Sempra Generation, which owns Mesquite Power, L.L.C. (“Mesquite”).

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

A.2 I am testifying on behalf of Mesquite, Southwestern Power Group II, L.L.C. (“SWPG”) and Bowie Power Station, L.L.C. (“Bowie”) (collectively “Mesquite Group”). The Mesquite Group was granted intervention in this proceeding by means of a Procedural Order issued on April 25, 2008. Thereafter, we were active participants throughout the settlement negotiations which resulted in the June 12, 2009 Settlement Agreement that has been filed with the Commission.

Q.3 Have the members of the Mesquite Group previously participated in proceedings before the Commission in which Arizona Public Service Company (“APS”) was either the Applicant or a major participant?

A.3 Yes, we have actually participated in a number of proceedings of that nature before the Commission. Included among those proceedings were (i) the Track “A” proceeding, (ii) the Track “B” proceeding, (iii) APS’ \$500 million financing proceeding, (iv) APS’ acquisition of the Sundance Generating assets, (v) APS’ 2003 rate case, (vi) APS’ 2005 Power Supply Adjuster/Surcharge proceeding, (vii) APS’ request for an emergency interim rate increase, (viii) APS’ 2005 rate case, (ix) APS’ Yuma RFP proceeding, (x) the APS “self-build” moratorium 40-252 proceeding and (xi) this rate proceeding.

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Q.4 What is the purpose of your testimony at this time?

A.4 Each of the companies comprising the Mesquite Group has signed the Settlement Agreement. Pursuant to the Procedural Order issued by the Chief Administrative Law Judge Lyn Farmer on May 3, 2009, the Mesquite Group is providing this Direct Testimony in support of the Settlement Agreement as it relates to their collective interests.

Q.5 What is the nature of those “collective interests” as they pertain to this proceeding?

A.5 The members of the Mesquite Group participate as actual and prospective vendors in the competitive wholesale power supply market in Arizona. Originally, their participation relied upon conventional sources of electric generation, such as natural gas-fired combined cycle electric generation facilities. Examples of these are the 1,250 MW Mesquite generation facility, which has been in service since 2003; and, the 1,000 MW Bowie power station, which is currently under construction. In more recent years, the members of the Mesquite Group (or affiliated entities) have begun to include generation projects which utilize renewable technology in their respective business plans and marketing activities. In addition, SWPG is serving as Project Manager for the proposed Sun Zia renewables energy transmission project, which entails 460 miles of 500 kV double-circuit electric transmission facilities in Arizona and New Mexico.

Q.6 Have one or more members of the Mesquite Group participated in competitive power procurements conducted by APS?

A.6 Yes. It is my understanding that at various times since 2003 one or more members of the Mesquite Group (or affiliated entities) have participated in Request(s) For Proposal (“RFP”) and other forms of competitive procurement conducted by APS, which have involved both conventional and renewable sources of generation.

1 **Q.7 Does the Mesquite Group believe that the Settlement Agreement adequately**
2 **addresses its “collective interests”?**

3 A.7 Yes, for reasons I will discuss in my testimony.
4

5 **Q.8 Please identify those areas of the Settlement Agreement which you will address in**
6 **your testimony.**

7 A.8 I will be discussing portions of Sections I (Recitals), II (Rate Case Stability Provisions),
8 VIII (Equity Infusions), XIII (Periodic Evaluation) and XV (Renewable Energy).
9

10 **Q.9 Please begin your discussion with Section I (Recitals).**

11 A.9 Typically, Recitals are used to provide background and context for the document in
12 question. In this instance, the language of Paragraphs 1.4, 1.7 and 1.15 is very important
13 to the Mesquite Group because it expressly recognizes that APS’ credit ratings directly
14 impact both (i) its ability to raise capital on favorable terms for capital expenditures, and
15 (ii) its ability to obtain credit on favorable terms from vendors as a purchaser in the
16 competitive wholesale electric market. In turn, this latter recognition is reflective of the
17 Commission’s previous policy determination that the ongoing existence of a viable
18 competitive wholesale electric market in Arizona is in the best interest of both Arizona’s
19 electric utilities and their ratepayers. Given APS’ status as the largest electric utility in
20 the state of Arizona, and its role as a major purchaser in the competitive wholesale
21 electric market, its financial stability and resulting creditworthiness is essential to the
22 successful functioning and viability of that market.

23 As the Commission is aware, sometimes the most appropriate power resource
24 choice for an electric utility is a long-term Purchased Power Agreement or the acquisition
25 of a developer-build project. Other times, the most appropriate choice may be a self-
26 build decision by the utility. Paragraphs 1.4, 1.7 and 1.15 of the Settlement Agreement
27 recognize the importance of providing and preserving this operational flexibility for APS
28 as a stated objective of the Settlement Agreement; and, that recognition enables the

1 Mesquite Group to support the Settlement Agreement. Before concluding my remarks on
2 this subject, I would note that Paragraph 3.4 of the Settlement Agreement also expressly
3 acknowledges the importance of such operational flexibility.
4

5 **Q.10 Please comment on Section II of the Settlement Agreement.**

6 A.10 Section II is entitled "Rate Case Stability Provisions," and that is precisely the intended
7 end result of the provisions contained in that portion of the Settlement Agreement.
8 Recent years have been characterized by a pattern of back-to-back APS rate or rate-
9 related proceedings before the Commission. In addition to the time and expense these
10 proceedings have entailed for all concerned, including the Mesquite Group, this
11 seemingly unbroken chain of proceedings has created uncertainty as to APS' financial
12 circumstances and stability for its ratepayers, its investors, its vendors and lenders, and
13 the financial community as a whole.

14 Against that background, the provisions of Section II are designed to provide a
15 measure of predictability as to the timing of, and appropriate intervals between, APS'
16 filing of rate cases for the next few years. In addition, in combination with the provisions
17 of other sections in the Settlement Agreement, the provisions of Section II are designed
18 to provide APS and the aforesaid stakeholders with a period of revenue stability during
19 the next few years. The Mesquite Group believes that such stability clearly is in the best
20 interests of all concerned.

21
22 **Q.11 Please discuss why the Mesquite Group believes Section VIII is an important part of**
23 **the Settlement Agreement.**

24 A.11 In addition to APS' agreement to complete infusions of at least \$700 million of additional
25 equity between June 1, 2009 and December 31, 2014, this section of the Settlement
26 Agreement contains several additional provisions which the Mesquite Group believes
27 will contribute to the financial stability and strength of APS during the next few years.
28

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1 More specifically, Paragraph 8.2 contains an express acknowledgement by APS
2 that the Company has a responsibility to exert its "best efforts" to both (i) maintain
3 investment grade financial ratios and a balanced capital structure, and (ii) work to
4 improve its existing ratings with the financial rating agencies. Each of these, in turn, will
5 contribute towards improving the financial stability and creditworthiness of the
6 Company.

7 In that regard, Paragraph 8.4 provides that APS will prepare and submit to the
8 Commission and the signatory parties to the Settlement Agreement a "plan detailing steps
9 it [APS] intends to take to maintain and improve its financial ratings." The Mesquite
10 Group believes that this is a very important provision, because it will provide the
11 signatory parties with an opportunity to file comments, and the Commission an
12 opportunity to act, in advance of APS beginning to substantially implement its "plan," in
13 the event that the Commission and/or a signatory party or parties believe(s) that APS'
14 "plan" is poorly conceived or lacking in that detail to be desired. In the past, both the
15 Commission and intervenors in APS' interim and permanent rate proceedings have found
16 themselves in a reactive posture, where the options for ameliorative action were narrowly
17 circumscribed by then existing circumstances.

18
19 **Q.12 In the opinion of the Mesquite Group, is there a relationship between APS'**
20 **responsibilities under Section VIII of the Settlement Agreement, and the \$30 million**
21 **annual average reduction in expenditures by APS provided for in Section V of the**
22 **Settlement Agreement?**

23 A.12 Yes. The Mesquite Group believes it is incumbent upon APS to exert its best efforts to
24 reduce annual expenses, consistent with the ongoing provision of adequate and reliable
25 electric service at reasonable costs, as a part of the company's concerted effort to
26 stabilize its financial performance and improve its credit metrics. The \$30 million
27 average annual reduction in expenses provided for in the Settlement Agreement, and
28 which has been agreed to by APS, is consistent with our philosophy in that regard. It also

1 is our perception that APS intends to meet, if not exceed, that annual target as well as the
2 five (5)-year aggregate target of \$150 million. Achieving these targets should materially
3 assist APS in discharging its responsibilities under Paragraph 8.2.
4

5 **Q.13 Please comment on why the Mesquite Group believes that Section XIII is an**
6 **important part of the Settlement Agreement.**

7 A.13 Both the language and tone of Paragraph 13.1 establish a conceptual framework which
8 the Mesquite Group believes is very important. That paragraph provides as follows:

9
10 “13.1 The Signatories agree that the Company should exert its best efforts
11 on an ongoing basis to maximize opportunities for financial soundness
12 provided by virtue of this Agreement; and that such efforts by the
13 Company should be subject to periodic evaluation through the use of the
14 Performance Measurements and Reporting Requirements.” [emphasis
15 added]

16 As I have previously indicated, the Mesquite Group executed and supports the
17 Settlement Agreement, because it believes that the provisions of the same provide APS
18 with genuine opportunities to stabilize and improve its financial metrics and
19 creditworthiness to the benefit of its ratepayers, its investors, its vendors and lenders and
20 the financial community as a whole; and, the language of Paragraph 13.1 contains an
21 express recognition to that effect. At the same time, the Mesquite Group believes that
22 APS should be required to periodically report upon the activities it has undertaken to
23 maximize those opportunities, and the results of those activities. Paragraph 13.1 and the
24 provisions of Section XIII as a whole provide for such periodic reporting and evaluation,
25 and thus warrant the Mesquite Group’s support.

26 In that regard, and in addition to the general Financial Reporting provided for
27 under Section XIII (B) (i) through (xii) of the Settlement Agreement, the Mesquite Group
28 is also quite interested in the information to be reported under Paragraph 13.4 (b) (xii),
which requires APS to periodically report

1 “xii. Information regarding the Company’s level of major capital
2 expenditures, and its consideration of available alternatives in connection
3 with such capital expenditures for generation facilities.” [emphasis added]

4 The Mesquite Group believes that the periodic reporting of information of the nature
5 contemplated by this provision should enable the Commission and other interested
6 persons (such as the Mesquite Group) to determine (i) whether APS is giving appropriate
7 consideration to power resource alternatives and arrangements available from the
8 competitive market in connection with decisions APS makes to satisfy its power resource
9 requirements; and, (ii) whether APS has complied with the Commission’s Recommended
10 Best Practices for Procurement, the Commission’s RES regulations, and APS’ Renewable
11 Energy Competitive Procurement Procedure to the extent applicable.

12 **Q.14 Please discuss those portions of Section XV of the Settlement Agreement which are**
13 **of direct interest to the Mesquite Group.**

14 A.14 There are two (2), namely, Paragraph 15.1 and Paragraph 15.3. In that regard, as
15 indicated earlier in my testimony, in recent years the members of the Mesquite Group
16 have begun to include generation projects which utilize renewable technology in their
17 respective business plans and marketing activities.

18 Paragraph 15.1 provides that APS will exert its “best efforts” to significantly
19 acquire additional new renewable energy resources with in-service dates by or before
20 December 31, 2015. It is quite conceivable that some of these resources may offer
21 potential business opportunities to one (1) or more members of the Mesquite Group (or
22 affiliated entities).

23 Paragraph 15.3 expressly provides that APS shall file a “plan” with the
24 Commission for a utility scale photovoltaic generation project (with the indicated
25 commencement of construction date) within 120 days from a Commission decision
26 approving the Settlement Agreement. In addition, this paragraph expressly requires that
27 APS “shall initiate a competitive procurement” as the means for identifying and selecting
28 the project which will be the subject of APS’ “plan.” The competitive procurement must

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comply with APS' Renewable Energy Competitive Procurement Procedure to which I previously referred; and, pursuant to Paragraph 15.3, any signatory to the Settlement Agreement may file comments on APS' "plan." Both the contemplated timing of this particular project, and the use of a "competitive procurement" project selection process are matters in which the members of the Mesquite Group (or affiliated entities) have an interest.

Q.15 Does this complete your discussion of those areas of the Settlement Agreement that you wished to address in your pre-filed Direct Testimony?

A.15 Yes, it does.