BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF THE APPLICATION OF PUBLIC SERVICE COMPANY OF NEW MEXICO FOR APPROVAL TO ABANDON SAN JUAN GENERATING STATION UNITS 2 AND 3, ISSUANCE OF CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY FOR REPLACEMENT POWER RESOURCES, ISSUANCE OF ACCOUNTING ORDERS AND DETERMINATION OF RELATED RATEMAKING PRINCIPLES AND TREATMENT,	)	**Case No. 13-00_____-UT**
PUBLIC SERVICE COMPANY OF NEW MEXICO,	)	
Applicant	)	

DIRECT TESTIMONY

OF

GERARD T. ORTIZ

December 20, 2013

NMPRC CASE NO. 13-00_____-UT
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WITNESS FOR
PUBLIC SERVICE COMPANY OF NEW MEXICO

DIRECT TESTIMONY OF
GERARD T. ORTIZ
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I. INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Gerard T. Ortiz. I am Vice President, Regulatory Affairs, for Public Service Company of New Mexico ("PNM" or the "Company"). My business address is 414 Silver Avenue, SW, MS-1105, Albuquerque, New Mexico 87102.

Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS VICE PRESIDENT, REGULATORY AFFAIRS.

A. As Vice President, Regulatory Affairs, I am responsible for PNM's overall regulatory strategy in New Mexico. I oversee Pricing and Regulatory Services, Regulatory Policy and Case Management, Retail Renewable Energy and Integrated Resource Planning.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL QUALIFICATIONS.

A. I graduated from New Mexico State University in 1981 with a Bachelor of Science degree in Electrical Engineering. I obtained a Master of Business Administration degree, with a concentration in Finance, from the Robert O. Anderson Graduate School of Management at the University of New Mexico in 1988. I am a Registered Professional Engineer in the State of New Mexico (Registration No. 9687). Since 1981, I have been employed by PNM, and have held a variety of engineering, supervisory, and managerial positions in

Distribution Engineering, Electric Marketing, Business Planning, and Market Services in addition to my current assignment. A statement of my experience and qualifications, including a list of the New Mexico Public Regulation Commission ("NMPRC" or "Commission") proceedings in which I have testified or filed testimony, is attached as PNM Exhibit GTO-1.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS CASE?

A. The purpose of my testimony is to support PNM's Application for the following approvals, within nine months, but no later than twelve months, of the date of filing:

(1) abandonment of San Juan Generating Station ("SJGS" or "San Juan") Units 2 and 3 by December 31, 2017, with an accounting order allowing full recovery of the undepreciated investment in SJGS Units 2 and 3 as of the date of retirement through a regulatory asset amortized over twenty years with a carrying charge equivalent to PNM's pre-tax weighted average cost of capital ("WACC") on the unamortized balance;

(2) issuance of a certificate of public convenience and necessity ("CCN") to include Palo Verde Nuclear Generating Station ("PVNGS") Unit 3 as a supply resource to serve New Mexico retail customers effective January 1, 2018, at a value for ratemaking purposes of $335 million and recovery of the costs associated with funding the decommissioning trust for PVNGS Unit 3 on a pro-rata basis;

(3) issuance of a CCN and any other necessary approvals for the acquisition of an additional 78 megawatts ("MW") of capacity in SJGS Unit 4 effective January 1,

2015, at a value for ratemaking purposes of approximately $52.5 million in exchange for an equal amount of capacity in SJGS Unit 3;

(4) recovery of the costs of selective non-catalytic reduction equipment ("SNCR") together with balanced draft on SJGS Units 1 and 4 to be installed by January 31, 2016, not to exceed $82 million, with cost overruns recovered in rates only after a Commission determination in a future rate case that they were prudently incurred, using 17.3.580 NMAC ("Rule 580") to guide the process; and,

(5) issuance of an accounting order allowing PNM's cost of compliance with the Best Available Retrofit Technology ("BART") determination for SJGS under the August 21, 2011, Federal Implementation Plan ("FIP") issued by the U.S Environmental Protection Agency ("EPA") to be placed in a regulatory asset for future recovery in a rate case, with a determination in this proceeding that such costs are reasonable and were prudently incurred.

These approvals are either necessary for, or facilitate, compliance with environmental requirements under the Clean Air Act ("CCA") for SJGS associated with a Revised State Implementation Plan ("Revised SIP") issued by the New Mexico Environmental Improvement Board ("EIB"), which is pending approval by the EPA.

II. SUMMARY OF TESTIMONY AND IDENTIFICATION OF WITNESSES

Q. PLEASE DESCRIBE THE TOPICS YOU WILL DISCUSS IN YOUR TESTIMONY.

A. I will begin by summarizing the key points I address in my testimony and then identifying the other witnesses PNM is presenting in support of the Application and the topics they will address. After that, I will describe in more detail the specific approvals PNM is requesting in its Application and why these approvals should be granted. I will also explain the timing associated with PNM's Application and other approvals necessary for the Revised SIP to be implemented. I will discuss the regulatory principles applicable to PNM's Application and the tests and factors to be considered in determining if the Application and its various components should be approved. I will also discuss past decisions of the Commission and its predecessors that may be relevant to consideration of the Application.

Q. PLEASE SUMMARIZE THE KEY POINTS YOU ADDRESS IN YOUR TESTIMONY.

A. There are a number of key points I address in my testimony in more detail. They include:

- It is in the public interest to abandon SJGS Units 2 and 3 because PNM has identified adequate alternatives to maintain service reliability to customers that are less costly than being able to continue to operate SJGS Units 2 and 3 with selective catalytic reduction ("SCR") technology installed on all four units of SJGS. These alternatives to operating SJGS under the FIP will mitigate exposure to future environmental regulations; result in a better balanced and diversified resource portfolio; and will be less risky in the face of always uncertain fuel prices and future carbon regulation. Under these circumstances,

the present and future public convenience and necessity do not require their continued operation.

- Proper regulation should allow full recovery of the undepreciated prudent investment in the retired plant in order to provide the proper regulatory incentives for management to make the appropriate economic decisions with regard to existing plant and facilities.
- The undepreciated investment in SJGS Units 2 and 3 was prudently incurred and PNM is acting reasonably in pursuing abandonment. Therefore, in order to properly balance the interests of customers and investors and the overall public interest, PNM should be allowed full recovery of the remaining prudent investment, amortized over a twenty year period with a carrying charge at PNM's pre-tax WACC on the unamortized balance. The used and useful concept is not a relevant consideration supporting a different result.
- The acquisition cost of the additional capacity in SJGS Unit 4 is the proper valuation for ratemaking purposes because customers benefit from the acquisition and the acquisition resulted from an arm's length transaction.
- PNM's offer to recertify PVNGS Unit 3 at its proposed value for ratemaking purposes is supported by the independent valuation analysis performed by Concentric Energy Advisors, Inc. and should be accepted by the Commission. Mr. O'Connell's testimony demonstrates that PVNGS Unit 3 is a less costly resource for PNM's customers than other alternatives even at a higher rate base valuation than what PNM is proposing. PVNGS Unit 3, as an existing nuclear plant with a recent license extension, provides numerous benefits over other alternatives, as demonstrated by the testimony of Mr. Olson.

- PNM's Application provides a path to comply with environmental requirements applicable to SJGS that costs less than other alternatives, provides a properly diversified supply portfolio and achieves greater overall environmental improvements than the FIP, which requires the installation of more costly SCR on all four units of SJGS, as discussed by Mr. Darnell. Under the circumstances presented, PNM's actions are prudent and reasonable, benefitting customers and the overall public interest, and its Application should be approved in its entirety.

Q. PLEASE BRIEFLY EXPLAIN THE DIFFERENCES AMONG THE REVISED SIP, THE TERM SHEET AND PNM'S APPLICATION IN THIS CASE.

A. As described in more detail in Mr. Darnell's testimony, the Revised SIP is New Mexico's plan, approved by the EIB, for complying with the EPA's Regional Haze Rule. It calls for achieving certain limits on nitrogen oxide ("NOx") emissions at SJGS by closing SJGS Units 2 and 3 and installing SNCR technology at SJGS Units 1 and 4. As explained in more detail by Mr. Darnell, the Revised SIP is not synonymous with the Term Sheet entered into among the New Mexico Environment Department ("NMED"), EPA and PNM. Neither is the Revised SIP nor the Term Sheet the same as PNM's Application in this case. PNM's Application is designed to seek the approvals that must be obtained from the Commission in order to comply with the Revised SIP and also seeks additional relevant approvals so that the proper balancing of customer and investor interests and the overall public interest is achieved.

Q. WHO ARE THE OTHER WITNESSES WHO WILL TESTIFY IN SUPPORT OF PNM'S APPLICATION IN THIS CASE?

A. Ronald Darnell, Senior Vice President, Public Policy for PNM, provides an overview of the environmental regulations applicable to SJGS's operations which are driving the need to retire SJGS Units 2 and 3 and find replacement power. He will summarize the history surrounding the environmental requirements under the CAA related to the BART NOx determination for SJGS. He will then discuss the limited options available to PNM to bring SJGS into compliance with the applicable environmental requirements, including the FIP issued by the EPA which would require the installation of expensive SCR on each operating unit of SJGS, and the proposed Revised SIP. In doing so, Mr. Darnell demonstrates the prudence and reasonableness of PNM's actions in pursuing the Revised SIP to benefit customers. Mr. Darnell will describe the overall environmental benefits of PNM's proposed plan compared to compliance with the FIP. He will also describe the Term Sheet and PNM's efforts to mitigate adverse impacts on the economy of the Four Corners region. Mr. Darnell explains that PNM is offering to have PVNGS Unit 3 recertified contingent on the Commission's adoption of PNM's proposed fair valuation of PVNGS Unit 3 for ratemaking purposes.

Chris Olson, Vice President, Generation for PNM, provides background concerning SJGS and its current ownership structure. He will explain that the Revised SIP will require a revised participation agreement resulting in a new ownership structure for SJGS following the implementation of the Revised SIP and the retirement of SJGS

Units 2 and 3. He explains that negotiations among the San Juan owners are currently underway. He explains that the probable minimum additional amount of capacity that PNM will acquire in SJGS Unit 4 to partially replace the capacity lost due to retirement of Units 2 and 3 is 78 MW. He summarizes the various regulatory approvals necessary for the revised ownership structure. To support the issuance of a CCN for additional capacity in SJGS Unit 4, he will discuss its operational and compliance status as well as its status as a source of continued reliable and cost-effective generation capacity. With regard to the approval of PNM's costs associated with the installation of SNCR and balanced draft on SJGS Units 1 and 4, he will discuss the cost of this technology and describe the processes and measures that PNM has taken to assure the reasonableness of these costs. He will describe the need for and benefits of installing balanced draft at this time. On the issue of a CCN for PNM's interest in PVNGS Unit 3, he provides a discussion of its recent operational and compliance status as well as the benefits of adding nuclear capacity from an existing facility to PNM's resource portfolio for serving New Mexico retail customers in order to partially replace the capacity lost due to the abandonment of SJGS Units 2 and 3. He also discusses the transmission capacity that is expected to be used to bring power from PVNGS Unit 3 to New Mexico retail customers. He explains why PNM had to incur certain initial costs associated with the installation of SCR on all four SJGS units in order to meet the compliance deadline under the FIP and describes the steps PNM took to ensure the reasonableness of the costs that were incurred.

Patrick J. O'Connell, PNM's Director of Planning and Resources, describes the proposed changes in PNM's supply portfolio to comply with the Revised SIP. Mr. O'Connell provides a more detailed explanation of possible alternatives to PNM's proposed plan to comply with the Revised SIP including: compliance with the FIP; compliance with the Revised SIP without recertifying PVNGS Unit 3; and early retirement of all four units of SJGS. He explains why PNM's proposal is the most cost-effective approach to maintaining service reliability while meeting the applicable environmental requirements. He shows that PVNGS Unit 3 is part of the most cost-effective resource portfolio even at valuations higher than the value proposed by PNM. Mr. O'Connell explains how PNM's approach comports with integrated resource planning ("IRP") requirements.

J. Edward Cichanowicz, an independent expert specializing in environmental control technologies for fossil fuel-fired power stations, provides testimony that explains the requirements of the EPA's Regional Haze Rule under the CAA relevant to the BART NOx determination for SJGS. He describes SNCR and its costs. He explains that the existing environmental emissions controls installed at SJGS Units 1 and 4 both complement and enhance the operation and performance of the SNCR. In addition Mr. Cichanowicz testifies that PNM's cost estimates for SNCR and balanced draft are reasonable and that SJGS Units 1 and 4 with SNCR and balanced draft will remain economically viable considering reasonably foreseeable future environmental regulations. Mr. Cichanowicz also discusses the

benefits of existing nuclear generation for purposes of compliance with air emission requirements relative to other alternatives.

Thomas Sategna, Vice President and Corporate Controller for PNM Resources, Inc. and PNM, explains the proper accounting treatment associated with abandonment of SJGS Units 2 and 3 and for the transfer of capacity between SJGS Units 3 and 4 to support the accounting orders requested by PNM. He describes the regulatory history of PVNGS Unit 3 as background for PNM's proposal to include it in rate base at the proposed fair valuation. In addition, Mr. Sategna provides testimony justifying the issuance of an accounting order authorizing PNM to record as a regulatory asset the costs incurred to comply with the FIP prior to agreement on the Term Sheet. He states that PNM will seek in a future rate case to recover the litigation costs associated with the FIP and the Revised SIP, including the costs associated with this Application, as well as the costs associated with negotiating the revised San Juan participation agreement.

John Reed, Chairman and Chief Executive Officer of Concentric Energy Advisors, Inc. and CE Capital Advisors (collectively, "Concentric"), presents Concentric's valuation study of PVNGS Unit 3 which supports the reasonableness of PNM's proposed rate base valuation.

Henry Monroy, Director, Cost of Service and Corporate Budget for PNM, identifies the costs associated with PNM's Application and provides a description

of the expected incremental revenue requirements and the estimated rate impacts on customers. Mr. Monroy explains the assumptions he used to develop the incremental revenue requirements, including assumptions regarding rate of return and jurisdictional allocation factors. He also compares the incremental revenue requirements associated with approval of PNM's Application with the incremental revenue requirements associated with the alternative scenarios described in Mr. O'Connell's testimony.

Terry Horn, Vice President and Treasurer for PNM Resources, Inc. and PNM, describes the methods PNM proposes to use to finance PNM's capital needs and why these methods are reasonable. Mr. Horn discusses the importance of fair and equitable treatment of investors for prudent investments made to reliably and cost-effectively serve customers so as to maintain, and hopefully improve, PNM's credit standing to the ultimate benefit of customers. Mr. Horn explains the need for Commission approval of the ratemaking principles and treatment associated with recertification of PVNGS Unit 3 proposed by PNM, including the rate base valuation needed by PNM in order to commit PVNGS Unit 3 to Commission jurisdiction. Mr. Horn describes the current status of the PVNGS Unit 3 decommissioning trust and explains PNM's request for approval of the proper ratemaking treatment for the trust consistent with PNM's request for a CCN for PVNGS Unit 3. Mr. Horn provides information regarding the ownership and leasing arrangements for PVNGS Units 1 and 2 and PNM's plans regarding the

PVNGS leases so that the Commission has a clear understanding of how the leases affect PNM's resource portfolio over the next few years.

III. ABANDONMENT OF SJGS UNITS 2 AND 3 AND REPLACEMENT POWER

Q. WHAT APPROVALS IS PNM SEEKING WITH REGARD TO SJGS UNITS 2 AND 3?

A. PNM is seeking authority to abandon SJGS Units 2 and 3 as utility property providing service to New Mexico retail customers effective December 31, 2017. Pursuant to the Revised SIP, if approved, SJGS Units 2 and 3 would be shut down.

Q. WHAT FACTORS DOES THE COMMISSION USE TO DETERMINE IF ABANDONMENT SHOULD BE AUTHORIZED?

A. The Commission has stated that "…an applicant for abandonment must make a factual showing that the proposed abandonment is consistent with the present and future public convenience and necessity, and that the public interest otherwise will in no way be disserved by the proposed abandonment."[1] To satisfy this factual showing, the Commission articulated what is known as the *Commuters' Committee* factors. These factors are: (1) the extent of the carrier's loss on the particular branch or portion of the service, and the relation of that loss to the carrier's operation as a whole; (2) the use of

[1] *Re Public Service Company of New Mexico,* 119 PUR 4th 48, 51 (NMPSC 1990, Case No. 2296), *aff'd Public Service Company of New Mexico v. New Mexico Public Service Commission,* 1991-NMSC-083, 112 N.M. 379, 815 P.2d 1169

the service by the public and prospects for future use; (3) a balancing of the carrier's loss with the inconvenience and hardship to the public upon discontinuance of service; and (4) the availability and adequacy of substitute service. The Commission's test is a flexible one that can and should be adapted to meet the specific facts and circumstances being evaluated.[2] Therefore, in some cases one or more of these factors may not be relevant and other relevant factors may be identified. For purposes of this case, I believe that there are two primary factors to be considered in determining the public convenience and necessity under the circumstances presented, which I will discuss later in my testimony.

Q. PLEASE ADDRESS THE *COMMUTERS' COMMITTEE* FACTORS IN THE CONTEXT OF PNM'S APPLICATION TO ABANDON SJGS UNITS 2 AND 3.

A. The first factor is irrelevant to the abandonment of SJGS Units 2 and 3. Both Units are in rate base and providing PNM an opportunity to receive its authorized rate of return. They are no more or less profitable than any other assets included in PNM's rate base from that perspective. In addition PNM's current rates provide for cost recovery of a representative amount of operating and maintenance expenses associated with SJGS Units 2 and 3. Thus, financial losses to PNM from operating SJGS Units 2 and 3 are not a consideration and not a reason for seeking abandonment.

The next three factors should be considered together. SJGS Units 2 and 3 are currently being used to serve the public and would continue to serve, with SCR installed, in the

[2] *Id.*

absence of lower cost alternatives. Because the Revised SIP, if all necessary approvals are obtained, would allow SJGS Units 1 and 4 to meet BART requirements under the EPA's Regional Haze Rule with much cheaper SNCR if, and only if, SJGS Units 2 and 3 are retired, there are lower cost alternatives to continued operation of SJGS Units 2 and 3. The alternative proposed in PNM's Application maintains service reliability to customers, does not impose hardship or inconvenience to the public, and results in benefits to customers from lower overall cost of service. Importantly, the alternative approach proposed in PNM's Application provides substantial environmental benefits not achievable with the operation of SJGS Units 2 and 3, even with the high cost SCR installed. Under these circumstances, it is my opinion that the present and future public convenience and necessity allows abandonment of SJGS Units 2 and 3 pursuant to PNM's Application.

Q. YOU MENTIONED TWO PRIMARY FACTORS THAT SHOULD BE CONSIDERED IN DETERMINING THE PUBLIC CONVENIENCE AND NECESSITY IN THIS CASE. WHAT ARE THEY?

A. I believe that the two primary factors are the availability of replacement power, or alternative sources of supply, and the relative economics associated with continued operation of SJGS Units 2 and 3 compared to the economics associated with retiring SJGS Units 2 and 3 and using the alternative sources of supply. These two factors are inherently considered in the last three *Commuters' Committee* factors when those three factors are properly analyzed together, as I have done earlier in my testimony.

Q. YOU MENTIONED THAT IT WAS IMPORTANT TO RECOGNIZE THE ADDITIONAL ENVIRONMENTAL BENEFITS REALIZED FROM PNM'S APPLICATION. WHY DO YOU BELIEVE THESE ADDITIONAL BENEFITS ARE RELEVANT?

A. I believe that the Commission's determination of the public convenience and necessity must be made considering the overall public interest, which in my mind is broader than the interests of customers. Although I am not providing a legal interpretation, I believe that this is at least implicitly indicated by the requirement in the New Mexico Public Utility Act ("PUA") that the Commission "shall specifically consider the impact of the proposed abandonment of service on all consumers served in this state, directly or indirectly, by the facilities sought to be abandoned."[3] This is further supported by the fact that the declaration of policy section of the PUA identifies the public interest as a separate consideration from the interests of consumers and investors.[4] Finally, identification of replacement power supplies is closely related to the principles and objectives of the IRP process as established by the Commission's IRP Rule. The IRP Rule states: "For resources whose costs and service quality are equivalent, the utility should prefer resources that minimize environmental impacts."[5]

Q. WHAT PROCESS HAS PNM USED TO ASSURE THAT PROPOSED ABANDONMENT OF SJGS UNITS 2 AND 3 IS CONSISTENT WITH THE

[3] NMSA 1978, § 62-9-5 (2005)
[4] NMSA 1978, § 62-3-1(B) (2008)
[5] 17.7.3.6 NMAC

FUTURE PUBLIC CONVENIENCE AND NECESSITY AND THAT THE PUBLIC INTEREST WILL NOT OTHERWISE BE DISSERVED?

A. PNM has performed the same resource planning analysis that would be employed during the preparation of its IRP. This is appropriate for a variety of reasons. First, New Mexico and the Commission require the development of a long-term resource plan through an IRP process. Second, resource planning requires a long-term view to ensure the development of the most cost-effective portfolio. Finally, the resources that PNM recommends to be brought in as jurisdictional resources between 2015 and 2018 not only replace the capacity for the retired SJGS Units, but will also become part of the foundation for PNM's long-term resource portfolio.

Q. HAVE THE REPLACEMENT RESOURCES TO BE DEPLOYED BETWEEN 2015 AND 2018 BEEN ADDRESSED IN PNM'S PAST IRP REPORTS?

A. No. Neither the 2008 nor the 2011 IRP reports contemplated retiring SJGS Units 2 and 3 with SNCR installed on SJGS Units 1 and 4. PNM filed its most recent IRP on July 18, 2011. Subsequently, protests to the 2011 IRP were filed by various environmental groups. On August 25, 2011, the Commission issued its Initial Order in Case No. 11-00317-UT setting the protests for hearing. Ultimately a hearing was never held. As a result the Commission neither expressly accepted the 2011 IRP as compliant with the IRP Rule nor allowed it to be deemed accepted as compliant pursuant to 17.7.3.12(A) NMAC. On September 16, 2013, PNM filed a Notice of Material Event pursuant to 17.7.3.10 NMAC regarding the EIB's approval of the Revised SIP which constitutes a material change during the time frame covered by the 2011 IRP four year action plan.

On September 18, 2013, the Commission issued a Notice of Proposed Dismissal ordering Case No. 11-00317-UT to be closed effective October 18, 2013, unless a motion demonstrating good cause to keep the docket open was filed by that date. No such motion was filed.

Although no protests were filed against the 2008 IRP and it was accepted by the Commission as compliant with the IRP Rule, its four year action plan is expired. As discussed in more detail by Mr. O'Connell, PNM has begun the IRP public advisory process required by the IRP Rule in order to file its next IRP in 2014. PNM has used the public advisory process for the 2014 IRP in the development of the resource plan presented in this filing.

Q. WHY NOT WAIT FOR THE 2014 IRP TO BE FILED?

A. Given the timelines for approval of the Revised SIP and related compliance deadlines, and the need for Commission approval of a major feature of the Revised SIP, i.e. abandonment of SJGS Units 2 and 3, PNM believes that it is necessary to file the Application early enough to give the Commission sufficient time to evaluate how to proceed to protect the present and future public convenience and necessity. As discussed more fully by Mr. O'Connell, PNM released information regarding the 2014 IRP for the public advisory process sooner than in previous years so as to be able to provide the Commission with information about public input even prior to the filing of the formal 2014 IRP.

Q. WHY IS IT NECESSARY TO TAKE A LONG-TERM VIEW WHEN CONDUCTING RESOURCE PLANNING?

A. There are several reasons why the long-term should be considered when undertaking a resource planning study. Resource alternatives generally have long useful lives. Decisions made today will necessarily affect decisions in the future. Basing decisions solely on immediate circumstances would undoubtedly result in a sub-optimal portfolio. For example, basing resource additions simply on load growth in a single year would likely result in bringing into service many small, peaking facilities or simply relying on power purchases in the wholesale market. This would foreclose the addition of any larger, more capital intensive but more efficient plants. The fuel source would be based primarily on the lowest priced fuel at any given time. This would not adequately take into account the variability of future fuel prices. This would likely result in a more expensive long-term portfolio. A long-term view, on the other hand, will base resource decisions on life-cycle cost analysis, and take into account the variability of future planning variables.

Q. WHAT REPLACEMENT POWER SUPPLIES HAS PNM IDENTIFIED THAT WOULD ASSURE THAT THE PROPOSED ABANDONMENT OF SJGS UNITS 2 AND 3 IS CONSISTENT WITH THE FUTURE PUBLIC CONVENIENCE AND NECESSITY AND THAT THE PUBLIC INTEREST WILL NOT OTHERWISE BE DISSERVED?

A. PNM has identified a cost-effective portfolio comprised of several resources to replace the approximately 418 MW of retired SJGS capacity. These resources include a

minimum of 78 MW of additional capacity in SJGS Unit 4 and PNM's share of PVNGS Unit 3 representing 134 MW for which CCNs are being requested in this case. Also, PNM's studies identify that 40 MW of new utility-scale solar, and a 177 MW gas plant, for which PNM plans to apply for CCNs in the future, as part of the cost-effective portfolio that will reliably serve customers' needs even with the retirement of SJGS Units 2 and 3. These proposed resources comprise a total of 429 MW. It is important to note that they were selected based on a twenty year planning analysis.

Q. IS PNM SEEKING APPROVAL FOR CCNS FOR ALL OF THESE RESOURCES IN THIS FILING?

A. No. At this time, PNM is only seeking CCNs for an additional 78 MW of capacity in SJGS Unit 4 and for the 134 MW represented by PNM's interest in PVNGS Unit 3 to replace the retired SJGS Units 2 and 3. As demonstrated by Mr. Olson, abandonment of SJGS Units 2 and 3 results in the loss of approximately 418 MW of baseload capacity in PNM's supply portfolio. PNM proposes to exchange 78 MW of capacity in SJGS Unit 3 for an additional 78 MW in SJGS Unit 4. This exchange reduces the amount of undepreciated investment in abandoned plant that must be recovered and should also help to resolve some of the complicated legal issues associated with SJGS Unit 4 ownership by California governmental utilities. SJGS Unit 4 has long been recognized by the Commission and its predecessors as a critical, low-cost resource in PNM's most cost-effective supply portfolio. Even with this additional capacity in SJGS Unit 4, the amount of coal-fired generation in PNM's diversified supply portfolio is reduced by 340 MW.

Next, as demonstrated by Mr. O'Connell, the results of his IRP analysis identifies PVNGS Unit 3 as a component of the most cost-effective portfolio, even at a valuation higher than offered by PNM. This will provide approximately 134 MW of additional low-cost nuclear capacity. I will address issues around issuing a CCN for PVNGS Unit 3 later in my testimony.

Q. WHAT ABOUT THE OTHER REPLACEMENT RESOURCES?

A. PNM and the State agreed that PNM would build a gas peaking plant in the future to be sited at SJGS with an estimated capacity of 150-200 MW to partially replace the power lost due to the retirement of SJGS Units 2 and 3. Mr. O'Connell's testimony demonstrates that this siting makes economic sense. However, PNM is not seeking a CCN for that plant at this stage nor for the solar capacity identified by Mr. O'Connell. Mr. O'Connell's analyses shows the resource additions that are projected to be necessary through 2018 to assure that customer needs are met in the most cost-effective manner, including the addition of gas generation and renewable energy resources. Further, as described by Mr. Olson, it is possible that negotiations regarding a new ownership structure might make additional capacity in SJGS Unit 4 beyond 78 MW available. Those actions, while not being approved in this case, help to demonstrate that abandonment of SJGS Units 2 and 3 is consistent with the present and future public convenience and necessity and that the public interest will not otherwise be disserved. Instead, the public interest will be served by approval of PNM's Application in this case. PNM's customer needs will be adequately and reliably served by a reasonable,

diversified, cost-effective supply portfolio with substantial environmental benefits that would not be achievable by the alternative of compliance with the FIP.

Q. WHY IS IT IMPORTANT TO HAVE A REASONABLY DIVERSIFIED SUPPLY PORTFOLIO?

A. The Commission and its predecessors have long recognized the benefits of diversifying the fuel mix of a supply portfolio. Fuel diversity is important in minimizing the risk that some unanticipated event may adversely impact the price or supply of any one fuel thereby adding more potential volatility to customers' electric bills. On the flip side, fuel diversity assures that customers will receive the benefits of events that favorably impact the price or supply of a particular fuel. Given the circumstances that exist today, it is reasonable to reduce the amount of coal and increase the amount of nuclear generation from existing nuclear plants in PNM's supply portfolio due to the likely increased regulation of greenhouse gas emissions. In the near term, additional amounts of gas generation and renewable energy resources are warranted. In my opinion, it would not be wise to totally eliminate any particular fuel source from a reasonably diversified supply portfolio. For example, although today there is increasing pressure on use of coal-fired generation due to increasing environmental requirements, existing coal plants remain cost-effective with their state-of-art suite of emissions controls, as described by Mr. Cichanowicz. And there is increasing pressure due to environmental concerns on natural gas production. I note that in 1978 the federal Powerplant and Industrial Fuel Use Act (now repealed) was enacted into law. It was designed to foster the use of coal and fuels other than natural gas as a boiler fuel in new plants due to concerns regarding

natural gas supplies. Although that is not a concern at this point in time, it demonstrates how the risks associated with a particular type of generation can change over time. There are also environmental concerns that have been raised with regard to renewable energy resources as well. For example, some environmental considerations involving solar and wind generation include land disturbance and other land use impacts; impacts to soil, water and air resources; impacts to vegetation, wildlife, wildlife habitat and sensitive species; visual, cultural, paleontological, socioeconomic, and environmental justice impacts; and potential impacts from hazardous materials. Given that the future can not be seen with perfect clarity, it is best to have a diversified supply portfolio.

Q. ARE THERE ADDITIONAL APPROVALS FOR THE REPLACEMENT POWER SUPPLIES THAT PNM IS SEEKING IN THIS CASE?

A. The PUA requires prior Commission approval for the sale, purchase or acquisition by a utility of public utility plant or property constituting an operating unit or system or a substantial part of an operating unit or system.[6] PNM does not believe that approval under this provision of the PUA is required for the trade of capacity between SJGS Unit 3 and Unit 4 due to the limited amount of capacity involved. However, if the Commission determines that approval under this provision of the PUA is required, PNM is requesting that it be granted.

Q. IF THIS ADDITIONAL APPROVAL IS REQUIRED, IS THERE AN ADDITIONAL SHOWING THAT PNM MUST MAKE?

[6] NMSA 1978, Section 62-6-12(A)(4) (1989)

A. No. The Commission has determined that approval pursuant to this section is met if the approval is sought in conjunction with issuance of a CCN or abandonment approval and the standard for granting a CCN or for authorizing abandonment is met.[7]

Q. WHAT ADDITIONAL AUTHORIZATIONS RELATED TO ABANDONMENT OF SJGS UNITS 2 AND 3 IS PNM SEEKING?

A. PNM is seeking authorization to recover in future rate cases the undepreciated investment in SJGS Units 2 and 3, including the accounting order described by Mr. Sategna. Mr. Monroy identifies the amount of the undepreciated investment and how it was calculated. Mr. Sategna identifies the period of time over which the undepreciated investment should be amortized and the carrying charge to be applied to the unrecovered amount until fully amortized.

Q. WHAT IS THE PROPER TEST TO USE TO DETERMINE IF RECOVERY OF THE UNDEPRECIATED INVESTMENT IN SJGS UNITS 2 AND 3 SHOULD BE ALLOWED AFTER THEY ARE ABANDONED?

A. The proper test is composed of two parts: (1) whether the investment at issue was prudently incurred; and, (2) whether it is reasonable to abandon the plant. Both parts of this test are met by PNM's Application.

Q. HOW SHOULD PRUDENCE BE DETERMINED?

[7] *Re Public Service Company of New Mexico,* 2013 WL 4045659, *3 (NMPRC Case No. 13-00004-UT)

A. The following description of prudence was adopted in NMPSC Case No. 2087 in the Order on Burden of Proof and Specific Issues to be Addressed and has continued to be relied on by the Commission:

> Prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made. In determining whether a judgment was prudently made, only those facts available at the time judgment was exercised can be considered. Hindsight review is impermissible.[8]

Under the prudent investment concept, customers are not to be charged for negligent, wasteful or improvident expenditures, or for the cost of management decisions which are not made in good faith. Customers are not expected to pay for management's lack of honesty or sound business judgment. Well-accepted regulatory practice is that every investment may be assumed to have been made in the exercise of reasonable judgment, unless the contrary is shown. This discussion of prudence was recently confirmed in PNM's last rate case, NMPRC Case No. 10-00086-UT.[9]

Q. HOW HAVE YOU DETERMINED THAT THE INVESTMENT IN SJGS UNITS 2 AND 3 WAS PRUDENTLY INCURRED?

A. A CCN was issued for PNM's ownership interests in SJGS Unit 2 in NMPSC Case No. 965 and for Unit 3 in NMPSC Case No. 1221. They have been included as a New Mexico retail jurisdictional resource and served PNM's customers for about forty years. PNM is only seeking approval to retire these two units because of increased

[8] Pages 4-5 (Oct. 4, 1988)
[9] Certification of Stipulation, page 61 (June 21, 2011), adopted by Final Order Partially Approving Certification of Stipulation (July 28, 2011)

environmental compliance costs associated with keeping them operational and because PNM has found a more cost-effective alternative to their continued operation in compliance with the FIP.

Since SJGS Units 2 and 3 were certified, none of the investment in them has ever been challenged as being imprudent or unreasonable in any way, with one exception that was rejected by the Commission which I will discuss shortly. The Commission has never determined that any portion of the investment in SJGS Units 2 and 3 should be denied rate recovery in any rate case. In NMPSC Case No. 2146, Part II, a case to determine which supply resources should be included in PNM's supply portfolio to serve New Mexico retail customers, there was no issue raised by anyone regarding SJGS Units 2 and 3. Similarly, in NMPRC Case No. 08-00305-UT, additional supply resources were identified to meet growing customer demand. No one questioned the continued use of SJGS Units 2 and 3. Also, stipulations adopted in NMPRC Case No. 3137 (Merchant Plant) and NMPRC Case No. 04-00315-UT sought to preserve use of PNM's low-cost baseload capacity, including SJGS Units 2 and 3, to serve PNM's New Mexico retail customers and existing wholesale firm supply customers.

The only time investment in SJGS Units 2 and 3 has been challenged was in PNM's last rate case, NMPRC Case No. 10-00086-UT. In that case an intervenor claimed that PNM's investment in pollution control technology for all four units of SJGS pursuant to a 2005 federal Consent Decree was imprudent. The Commission expressly rejected the

intervenor's argument.[10] Further, as discussed by Mr. Olson, continued investment in SJGS Units 2 and 3 is being limited to what is needed for prudent and reliable operation during the time they remain in service. Thus, there is no question that the investment in SJGS Units 2 and 3 was and is prudent.

Q. THE SECOND PART OF THE TEST YOU HAVE ARTICULATED IS WHETHER THE ABANDONMENT OF SJGS UNITS 2 AND 3 IS REASONABLE. HOW SHOULD REASONABLENESS IN THIS CONTEXT BE DETERMINED?

A. First, the Commission will make the ultimate determination about whether it is in the public interest for SJGS Units 2 and 3 to be abandoned under the circumstances. If it is not in the public interest, then the issue of rate recovery of retired plant investment becomes moot, although such a determination raises additional complex issues regarding installation of SCR to keep all four units operational due to the FIP. Second, the Commission will evaluate the reasonableness of PNM's overall actions and Application. Mr. Darnell has described in detail the actions PNM has taken to mitigate the economic effects on customers of compliance with environmental requirements under the CAA and the EPA's Regional Haze Rule. Regulation should provide the proper incentives for management to act reasonably. If it is reasonable to retire plant because there is a cheaper alternative for customers, that decision should not come with adverse financial impacts on shareholders. Otherwise there is a disincentive for management to make economic decisions regarding continuing operations of a plant,

[10] Final Order Partially Approving Certification of Stipulation, ¶¶ 150-153, at pages 65-67 (July 28, 2011)

which may no longer be economic due to obsolescence or other reasons, such as exist in this case where environmental compliance to keep them operating becomes more expensive than other alternatives.

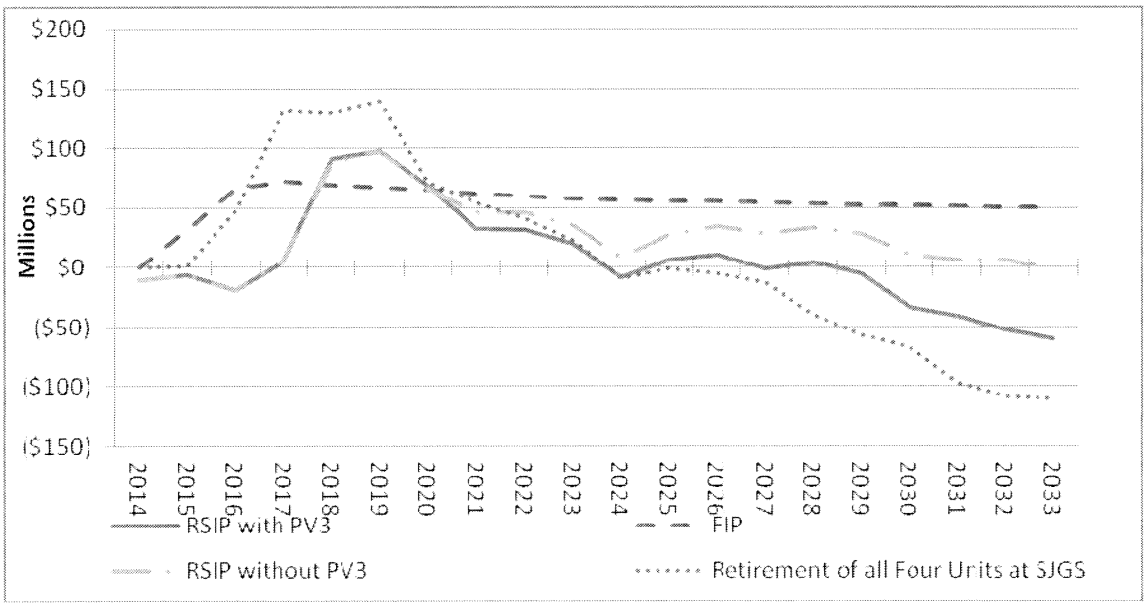
Generally, the Commission has determined reasonableness of expenditures by comparing the costs to the benefits. Mr. O'Connell in his testimony has provided a cost/benefit analysis that compares the cost of a portfolio to allow compliance with the Revised SIP to the cost of a portfolio that assumes the continued operation of all four SJGS units with SCR as required by the FIP. PNM has included in the costs of complying with the Revised SIP the costs associated with full recovery of the undepreciated investment in SJGS Units 2 and 3. As can be seen from Mr. O'Connell's analysis, customers are better off with the Revised SIP than any other feasible resource alternatives for meeting environmental requirements for SJGS under the Regional Haze Rule. The net benefits of the retirement alternative are the difference in the net present value between compliance with the Revised SIP and compliance with the FIP.

Q. SHOULD THE COMMISSION DETERMINE NET BENEFITS BY LOOKING AT IMMEDIATE RATE IMPACTS OR COSTS OVER A LONGER TIME FRAME?

A. Although immediate rate impacts are relevant for the Commission to consider, it is more appropriate to look at the present value of benefits over a longer time frame, such as the IRP planning horizon. If one looks only to the immediate impacts, it could mask the longer term impacts which could prove to be much more costly to customers in the long

run, or even the short to middle term. Mr. O'Connell's analysis demonstrates that the net present value of the costs of complying with the Revised SIP as proposed in PNM's Application is lower than the net present value of the costs of alternatives. As shown in Table 1, below, FIP compliance would have imposed cost impacts sooner than Revised SIP compliance pursuant to PNM's Application. Although the immediate cost impacts associated with PNM's Application are somewhat higher than the cost impacts associated with FIP compliance in 2018, the cost impacts associated with the FIP start earlier and the situation reverses within five years, with the cost impacts associated with PNM's Application decreasing rapidly while the cost impacts associated with FIP decline very little over the remainder of the planning horizon.

TABLE 1



Q. WHAT DO YOU CONCLUDE FROM THIS ANALYSIS?

A. PNM's remaining investment in SJGS Units 2 and 3 was prudently incurred and its actions resulting in retirement prior to full recovery is beneficial to customers. Therefore, PNM should be allowed full recovery of the undepreciated investment in SJGS Units 2 and 3.

Q. WHAT WOULD BE THE REPERCUSSIONS IF PNM IS REQUIRED TO WRITE OFF THE UNDEPRECIATED INVESTMENT AND NOT RECOVER IT IN RATES?

A. Although it may result in lower rates in the near-term, it would also result in very unbalanced impacts to shareholders and ultimately increase customer costs. As testified to by Mr. Horn, if shareholders are penalized for reasonable actions taken by PNM, PNM's status in the capital markets is unnecessarily harmed, causing increased capital costs in the future, potential credit rating actions and potential difficulties in accessing the capital markets on favorable terms and conditions. The higher cost of borrowing associated with these issues will ultimately be borne by consumers. Also, it must be emphasized that proper regulation balances the interests of customers and investors with neither interest being paramount. Recovery of the undepreciated investment in SJGS Units 2 and 3 is necessary to properly balance the interests of customers, investors and the overall public interest.

Q. IS THE "USED AND USEFUL" CONCEPT A RELEVANT CONSIDERATION IN THIS ANALYSIS?

A. No. In order to properly balance the interests of customers and investors, as well as the overall public interest, the used and useful concept is not a proper consideration in the determination of whether or not the undepreciated investment in SJGS Units 2 and 3 should be recovered after retirement. I have already described the proper test to be used.

Q. WHY NOT?

A. There are a number of reasons. First, the Commission has been clear in previous cases that the used and useful concept is only one factor to be considered in ratemaking. The Commission has said that the appropriate ratemaking treatment of plant does not automatically follow from a used and useful determination.[11]

Second, strict application of the used and useful concept in these circumstances ignores that SJGS Units 2 and 3 have been used and useful in serving customer needs for approximately forty years. PNM has continued to invest in these plants to keep them operational and reliable precisely because they have long been an important low-cost resource in a cost-effective supply portfolio. To ignore this history sends the wrong incentive to utility management regarding the actions to be taken involving resource decisions. As demonstrated, PNM is seeking to retire SJGS Units 2 and 3 because doing so, even with full recovery of the undepreciated investment, is more cost-effective for customers and provides greater environmental benefits than keeping them operational in compliance with the FIP. Thus, full recovery of undepreciated investment

[11] *Re Public Service Company of New Mexico,* 101 PUR 4th 126, 163 (NMPSC Case No. 2146, Pt. II, 1989), *aff'd New Mexico Industrial Energy Consumers v. New Mexico Public Service Commission,* 1991-NMSC-018, 111 N.M. 622, 808 P.2d 592; *Re Public Service Company of New Mexico,* 157 PUR 4th 540, 567-568 (NMPUC Case No. 2567, 1994)

under these circumstances is the only way to properly balance the interests of customers and investors and the overall public interest.

Finally, the used and useful concept is a factor that may be considered for purposes of rate base valuation. As a general regulatory principle, it is not a consideration in determining the amount of expenses that should be recovered. That is determined by reference to prudence and overall reasonableness of the expense to be recovered. As discussed by Mr. Sategna, when plant is retired the remaining costs are taken out of plant in service and should be placed in a regulatory asset account to be amortized over a specified period of time. Without an accounting order such as described by Mr. Sategna, the undepreciated investment becomes an expense item that flows through the profit and loss statement in one year. The accounting order allows amortization of this large expense item over time to mitigate the impacts on both customers and investors. Thus the used and useful concept is not applicable to a determination of whether the undepreciated investment in abandoned plant should be recovered in rates.

IV. CCN APPLICATION FOR ADDITIONAL CAPACITY IN SJGS UNIT 4 AND RECERTIFICATION OF PVNGS UNIT 3

Q. FOR WHAT FACILITIES IS PNM SEEKING A CCN IN THIS CASE?

A. PNM is seeking a CCN for additional capacity in SJGS Unit 4 and its ownership interest in PVNGS Unit 3.

Q. WHAT FACTORS DOES THE COMMISSION TRADITIONALLY CONSIDER IN DECIDING ON A CCN APPLICATION FOR OPERATION OF UTILITY PLANT?

A. As its name indicates, the Commission considers the public convenience and necessity. The Commission generally has equated the public convenience and necessity with the public interest and has stated that the standard implies a net public benefit.[12] Because the need for additional capacity in SJGS Unit 4 and recertification of PVNGS Unit 3 is dependent on the approval of abandonment of SJGS Units 2 and 3, the requests for abandonment and CCNs for replacement power must be viewed together. I have already addressed the benefits of abandoning SJGS Units 2 and 3, which are dependent on identifying cost-effective replacement power supplies which includes the additional capacity in SJGS Unit 4. Mr. O'Connell's and Mr. Olson's testimony and exhibits provide the demonstration of the net benefits to be derived from providing a CCN for the operation of the additional 78 MW of capacity in SJGS Unit 4 and recertification of PVNGS Unit 3.

Q. ARE THERE OTHER FACTORS THAT MAY BE CONSIDERED?

A. Yes. PNM must demonstrate consistency with its most recent IRP that has been accepted by the Commission, or demonstrate that material changes have occurred which warrant a different course of action. Also, Staff witnesses have testified in previous cases that Staff applies the following standards to its review of CCN applications: (1)

[12] NMPRC Case No. 13-00004-UT, Recommended Decision, page 3 (May 23, 2013), *adopted by* Final Order on Recommended Decision (June 26, 2013)

there is a need for the facility; (2) the facility is the most economical choice among the feasible alternatives; (3) no environmental violations are noted; and, (4) no valid public opposition is received or the applicant is able to mitigate valid public concerns and impacts, thus making the project in the public interest.

Q. ARE THESE STANDARDS SATISFIED IN THIS CASE?

A. Yes. As demonstrated by Mr. O'Connell, PNM is currently in the process of preparing its 2014 IRP. Earlier in my testimony I discussed the status of the 2011 IRP, including PNM's filing of a Notice of Material Event. Neither it nor the 2008 IRP contemplated the need to identify replacement resources due to retirement of SJGS Units 2 and 3. The adoption of the Revised SIP by the EIB represents a material change warranting a different course of action from what has been provided in earlier IRPs. Clearly there is a need for additional capacity if SJGS Units 2 and 3 are abandoned. Compliance with the Revised SIP as proposed by PNM is the most economical choice among the feasible alternatives. PNM's Application is designed to meet environmental requirements.

Q. WHAT ABOUT THE OTHER FACTORS THAT STAFF TRADITIONALLY CONSIDERS?

A. Mr. Olson discusses SJGS Unit 4 and PVNGS Unit 3 compliance with environmental requirements. PNM understands that some groups may object to PNM acquiring additional capacity in SJGS Unit 4 because of their belief that PNM should not have any interest in coal generation at all. That opposition may be expressed through interventions in this case. However, PNM believes that such opposition is not valid.

PNM's additional ownership does not mean that there will be more coal generation coming from SJGS Unit 4 under the Revised SIP. And the net amount of PNM's ownership of coal generation is reduced by 340 MW under PNM's Application. The opposition from some segments of the public must be balanced by the positive economic impact to PNM's customers, especially given the fact that PNM's additional ownership interest will have zero environmental impact. In addition there have been concerns raised about the impact on the economy of the Four Corners region of New Mexico. Mr. Darnell discusses the measures agreed to by PNM to mitigate the adverse impacts. Also, because PVNGS Unit 3 has already been built and initially certified by the Commission, and it continues to operate, PNM is not aware of any public opposition to having it recertified for New Mexico retail customers.

Q. WHAT ELSE MUST PNM SHOW IN ORDER TO OBTAIN A CCN?

A. Section 62-9-6 of the PUA requires a showing that, if the applicant is a corporation, it must have its articles of incorporation on file with the Commission. In addition, the PUA requires evidence, as the Commission may require, to demonstrate the consent and franchise of the municipality where the construction and operation of the facility is proposed. I am attaching to my testimony as PNM Exhibit GTO-2 a copy of PNM's currently effective articles of incorporation. I do not believe that the provision requiring evidence of consent by the municipality wherein operation is proposed is applicable. SJGS is not located within the boundaries of any municipality. I would also point out that PNM was already granted a CCN for ownership of 50% of SJGS Unit 4 in NMPSC Case No. 1221 in 1975. As with SJGS Unit 4, I do not believe that this provision of the

PUA is applicable to the circumstances of PVNGS Unit 3. PVNGS is located about fifty miles west of Phoenix, Arizona, outside of any municipality. PNM's existing interest in PVNGS Unit 3 was originally certified by the Commission in NMPSC Case No. 1216 in 1977.

Q. WHAT IS THE CONSIDERATION PNM IS LIKELY TO PAY FOR THE ADDITIONAL 78 MW OF SJGS UNIT 4?

A. PNM will likely trade its interest in an equivalent amount of capacity in SJGS Unit 3. PNM is seeking approval to consummate the transfer as of January 1, 2015. The estimated net book value of the SJGS Unit 3 capacity at January 1, 2015, is approximately $52.5 million ($673/kW). The estimated net book value of the SJGS Unit 4 capacity at January 1, 2015, is approximately $50.7 million ($650/kW).

Q. WHAT VALUATION DOES PNM PROPOSE FOR RATEMAKING PURPOSES?

A. PNM proposes that the additional capacity in SJGS Unit 4 be valued for ratemaking purposes at its exchange value, i.e. the net book value of 78 MW of SJGS Unit 3 which is estimated to be approximately $52.5 million. In addition there will be additional investments that will be made in Unit 4 that will be added to rate base, including the addition of SNCR and balanced draft.

Q. WHY IS THIS VALUATION REASONABLE FOR RATEMAKING PURPOSES?

A. Although the estimated net book value of 78 MW of capacity in SJGS Unit 3 is slightly higher than the equivalent amount of capacity in SJGS Unit 4, the proposed exchange results in net benefits to customers by facilitating compliance with the Revised SIP and avoiding the higher costs associated with other alternatives. By acquiring additional capacity in SJGS Unit 4 from M-S-R and Anaheim in exchange for the equivalent amount of capacity in SJGS Unit 3 prior to retirement, the amount of plant PNM is abandoning is reduced and so is the amount of undepreciated investment that should be recovered, benefitting both customers and shareholders. The fact that the exchange value may be higher than the net book value for 78 MW of Unit 4 does not mean that the acquisition premium should not be recovered in rates. The acquisition is an arm's length transaction. M-S-R and Anaheim on one side of the transaction and PNM on the other side, are unrelated parties acting in their own perceived best interests, with experienced and qualified advisors. Further, PNM's customers benefit from the transaction as already explained.

Q. WHY DOES PNM NEED A CCN FOR PVNGS UNIT 3 TO SERVE NEW MEXICO RETAIL CUSTOMERS IF PVNGS UNITS 1 AND 2 ARE ALREADY PROVIDING SERVICE?

A. All three units of PVNGS were granted CCNs in NMPSC Case No. 1216. However, in the late 1980's after the three units of PVNGS became operational, PNM was confronted with having more capacity available to serve customers than the demand for electricity plus a reasonable reserve margin. Due to a number of factors, including impacts on the overall economy from the Arab Oil Embargo of the 1970's and the Three

Mile Island accident, the costs of constructing PVNGS increased dramatically to reflect extremely high financing costs and additional safety measures. Thus the New Mexico Public Service Commission ("NMPSC") was confronted with the need to develop a regulatory plan to properly balance customer and investor interests. Part of that plan was exclusion of PVNGS Unit 3 as a jurisdictional resource. The NMPSC at that time determined that the then present and the future public convenience and necessity, as the NMPSC foresaw it, did not and would not require the use of PVNGS Unit 3 to serve New Mexico retail customers and so authorized its abandonment and decertification. PNM was allowed to make whatever use of it was in the best interests of its shareholders, subject to a hazard sharing arrangement wherein PVNGS Unit 3 supplies needed power to replace power from PVNGS Units 1 or 2 if either of those Units is out of service. Since that time PNM has sold power on the wholesale market from PVNGS Unit 3, the revenues of which have not been counted for jurisdictional ratemaking purposes. All those revenues have accrued exclusively to shareholders. However, since the NMPSC order of abandonment, there have been dramatic changes in power supply needs for New Mexico retail customers that have been caused by new and emerging environmental requirements on coal generation. While nuclear generation remains extremely expensive to build, existing nuclear generation is relatively inexpensive to operate and has zero greenhouse gas emissions. Mr. Olson discusses the transmission arrangements in place to assure available capacity to deliver power from all three PVNGS Units on a consistent basis. Mr. Horn addresses the decommissioning requirements associated with PVNGS Unit 3.

Q. WHY SHOULD THE COMMISSION GRANT A CCN FOR PVNGS UNIT 3 TO SERVE NEW MEXICO RETAIL CUSTOMERS?

A. As described by Mr. O'Connell, PNM's analysis shows PVNGS Unit 3 as part of the most cost-effective supply portfolio for PNM even at higher valuations than offered by PNM. In addition to capital costs, there is a wide range of factors that must be considered when evaluating resource alternatives including: fuel costs, other O&M costs, availability of existing plants as opposed to construction of new plants, permitting risks for new plants, reliability, transmission concerns and decommissioning funding. Consideration of these factors points to adding PVNGS Unit 3 to PNM's resource portfolio for serving New Mexico retail customers. Its addition contributes to a properly balanced diversified supply portfolio of nuclear, coal, gas and renewable energy which helps mitigate against the risk of future greenhouse gas emission regulation and volatility of gas prices. The capacity from PVNGS Unit 3 is already owned by PNM and, though decertified and abandoned by the NMPSC almost 25 years ago, it has been used to serve New Mexico retail customers under the hazard sharing arrangement I mentioned earlier. As discussed in more detail by Mr. Olson, it is a high capacity factor plant with an excellent operational track record. Its license to operate has been extended to 2047 by the Nuclear Regulatory Commission. When plant reliability, operating costs and emissions are considered, existing nuclear generation becomes an even more attractive resource.

Q. WHAT VALUATION FOR PVNGS UNIT 3 IS PNM PROPOSING FOR RATEMAKING PURPOSES?

A. PVNGS Unit 3 is not currently subject to Commission jurisdiction. As with the acquisition of any new resource, the acquisition of PVNGS Unit 3 as a jurisdictional resource should be at a fair valuation. A fair valuation in this context is one which fairly compensates PNM for giving up its right to continue operating PVNGS Unit 3 as a resource excluded from Commission jurisdiction, retaining all income through license expiration for the benefit of shareholders. Mr. Darnell identifies the valuation for ratemaking purposes which PNM is willing to accept as fair. Mr. Horn discusses further the proper valuation for PVNGS Unit 3 for ratemaking purposes. This valuation is supported by the independent valuation analysis provided by Mr. Reed.

V. CONCLUSION

Q. WHAT CONCLUSIONS SHOULD BE DRAWN FROM YOUR TESTIMONY?

A. Compliance with the Revised SIP which allows SJGS Units 1 and 4 to operate with NOx emissions limits based on SNCR technology, technology that is much less expensive than SCR technology required by the FIP, is more beneficial to the public than is continued operation of all four units of SJGS with SCR and, for that matter, abandonment of all four units of SJGS which is higher cost and the highest risk alternative analyzed by Mr. O'Connell. The use of SNCR on SJGS Units 1 and 4 is contingent on retiring SJGS Units 2 and 3. Since PNM needs the power that would otherwise be provided by SJGS Units 2 and 3, abandonment can only be allowed if economic replacement power is identified. PNM has identified economic replacement power and therefore compliance with the Revised SIP provides net benefits to customers

by not having to comply with EPA's FIP. The valuation of the identified additional capacity is reasonable under the circumstances due to the net benefits provided to customers by the additional capacity at the proposed valuation. PNM's Application should be approved as presented.

Q. BY WHAT DATE DOES PNM NEED A DECISION FROM THE COMMISSION?

A. The PUA states that if the Commission has not issued an order granting or denying an application for a CCN within nine months from the date the application is filed with the Commission, approval is deemed granted. However, for good cause the Commission may extend the time for an additional six months.[13] If the Commission is able to issue an order within the nine month statutory period, i.e. no later than September 20, 2014, that would be close to the point in time when the EPA is expected to act on the Revised SIP. A final order from the Commission in this case would be an important factor for the EPA as it decides whether to approve the Revised SIP. However, if the Commission determines that additional time is necessary, PNM requests that the Commission extend the time no more than an additional three months to December 20, 2014, which coordinates with the anticipated timing of a CCN application for the additional gas generation resources I have described in my testimony. In addition, PNM anticipates beginning construction of the SNCR project in November or December of 2014 to meet the target in-service date of January 2016. This also supports PNM's request for an

[13] NMSA 1978, § 62-9-1(C) (2005)

order in this case by September 2014. PNM believes that a year is sufficient time to conduct the proceedings in this case.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

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