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

THOMAS G. SATEGNA

December 20, 2013

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

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NMPRC CASE NO. 13-00_______-UT

I. INTRODUCTION AND PURPOSE

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

A. My name is Thomas G. Sategna. I am the Vice President and Corporate Controller for PNM Resources, Inc., and its subsidiaries, which includes Public Service Company of New Mexico ("PNM" or the "Company"). My address is 414 Silver Avenue, SW, Albuquerque, New Mexico 87102.

Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS VICE PRESIDENT AND CORPORATE CONTROLLER.

A. As Vice President and Corporate Controller I am responsible for all accounting matters as they relate to PNM Resources, Inc., and its subsidiaries.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN UTILITY REGULATION PROCEEDINGS?

A. Yes, I have filed testimony before the New Mexico Public Regulation Commission ("NMPRC" or "Commission") and its predecessors, the Federal Energy Regulatory Commission ("FERC") and the Public Utility Commission of Texas. My qualifications and a list of proceedings in which I have filed testimony or testified are included in PNM Exhibit TGS-1.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. The purpose of my direct testimony is to support PNM's Application for various approvals which will allow it to comply with environmental requirements for the San Juan Generating Station ("SJGS" or "San Juan") under the Clean Air Act and for determinations of related ratemaking principles and treatment. Approval of the Application will include approval of the retirement of SJGS Units 2 and 3, a Certificate of Public Convenience and Necessity ("CCN") for the exchange of 78 MW of PNM's ownership in SJGS Unit 3 for 78 MW of ownership in SJGS Unit 4, and a CCN for PNM's 134 MW interest in Palo Verde Nuclear Generating Station ("PVNGS") Unit 3 to serve New Mexico retail customers at a value for ratemaking purposes of $335.0 million ($2,500 per kW). In the sections that follow, I will address the following:

- The accounting treatment for the exchange of 78 MW of ownership in SJGS Units 3 for 78 MW of Unit 4;
- The accounting treatment for the retirement of SJGS Units 2 and 3 and PNM's proposal to recover the undepreciated investment associated with these two units from jurisdictional customers;
- The accounting order the Company will need to: (1) record the undepreciated investment as a regulatory asset on its balance sheet, and (2) avoid balance sheet write-offs associated with the retirement of SJGS Units 2 and 3;
- The regulatory history and accounting treatment of PVNGS Unit 3, including its exclusion from jurisdictional rates and ultimate abandonment and decertification by the New Mexico Public Service Commission ("NMPSC") in Case No. 2285;

- The $181.3 million impairment loss the Company recorded in 1992 related to the exclusion from rates, abandonment and decertification of PVNGS Unit 3;
- The accounting treatment for bringing PVNGS Unit 3 into rate base at a fair value for ratemaking purposes as described in the direct testimonies of Mr. Ronald Darnell, Mr. Terry Horn and Mr. John J. Reed; and
- The accounting order the Company will need for allowing PNM's costs 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 recorded as a regulatory asset for future recovery in a general rate case. A discussion and estimate of the costs to be recovered are included later in my testimony.

II. SJGS OWNERSHIP EXCHANGE AND RETIREMENT

Q. WHAT TOPICS WILL YOU ADDRESS IN THIS SECTION OF YOUR DIRECT TESTIMONY?

A. In this section of my direct testimony, I address the accounting treatment for the exchange of 78 MW of PNM owned capacity in SJGS Unit 3 for 78 MW of capacity in Unit 4 from two California utilities, and the retirement of SJGS Units 2 and 3. I will also address the accounting order needed from the Commission to record the undepreciated investment in SJGS Units 2 and 3 on the Company's balance sheet as a regulatory asset and avoid any impairment loss associated with the retirement of those units.

Q. BEFORE YOU ADDRESS THE ACCOUNTING TREATMENT FOR THE 78 MW EXCHANGE, ARE THE CURRENT AND PROJECTED VALUES FOR SJGS UNITS 3 AND 4 THE SAME?

A. No. The value of SJGS Unit 3 on a $/kW basis on June 30, 2013, and projected at January 1, 2015, are higher than the value of SJGS Unit 4. Mr. Henry Monroy provides the June 30, 2013, and projected January 1, 2015, values for SJGS Units 3 and 4 in PNM Exhibit HEM-4.

Q. WHEN WILL THIS EXCHANGE TAKE PLACE?

A. The timing of the transfer will be determined when the San Juan Plant Participation Agreement (the "SJPPA") is amended and approved by the owners of the SJGS and is contingent upon Commission approval of PNM's Application to this case. For purposes of this filing, the Company has assumed the transfer will take place on January 1, 2015.

Q. HOW WILL THE EXCHANGE BE TREATED FOR RATEMAKING PURPOSES?

A. As discussed in Mr. Monroy's testimony, the Company will value the additional 78 MW in Unit 4 at the net book value (original cost less accumulated depreciation) of PNM's ownership in Unit 3 at the date of the exchange. Because the 78 MW of SJGS Unit 3 is presently included in jurisdictional rates, the exchange will not impose additional costs on customers.

Q. HOW DO THE ACCOUNTING RULES UNDER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ("GAAP") IMPACT HOW THE COMPANY WILL RECORD THE EXCHANGE ON ITS FINANCIAL STATEMENTS?

A. Under GAAP, specifically Accounting Standards Codification ("ASC") 845, the accounting for nonmonetary exchange transactions should be based on the fair value of the assets involved. In applying this concept to ASC 980 (formerly Statement of Financial Accounting Standards ("SFAS") 71) and the FERC Uniform System of Accounts, 18 CFR Chapter 1, Subchapter C, Part 101, Electric Plant Instructions, it is reasonable to conclude that the fair value of SJGS Unit 4 is equivalent to the net book value of SJGS Unit 3. Therefore, there will be no change in how the plant is valued and reported on the Company's financial statements as a result of the exchange.

Q. BEFORE YOU DESCRIBE THE ACCOUNTING ORDER THE COMPANY IS REQUESTING, PLEASE DEFINE UNDEPRECIATED INVESTMENT AS THE TERM RELATES TO SJGS UNITS 2 AND 3.

A. The term undepreciated investment represents the net book value (original cost less accumulated depreciation) of PNM's investment in SJGS Units 2 and 3 projected at the time of retirement of the two units on December 31, 2017. Mr. Monroy provides the projected net book value at that date in his direct testimony. The Company is seeking Commission approval to record the actual undepreciated investment as of December 31, 2017, as a regulatory asset and to amortize it over a twenty-year time period with a carrying charge equal to the Company's pre-tax weighted average cost of capital.

Q. PLEASE DESCRIBE THE ACCOUNTING ORDER THAT THE COMPANY IS REQUESTING WITH RESPECT TO UNDEPRECIATED INVESTMENT IN SJGS UNITS 2 AND 3.

A. The Company is requesting an accounting order that specifically identifies the amount of the regulatory asset to be recorded as the actual undepreciated investment at December 31, 2017. This specific identification is necessary in order for the Company to transfer the amount out of FERC Account 101 (Electric Plant in Service) to FERC Account 182.2 (Unrecovered Plant Costs), which is a regulatory asset account. According to 18 CFR Chapter 1, Subchapter C, Part 101, significant unrecovered plant costs resulting from the early retirement of the plant should be recorded as a regulatory asset in FERC Account 182.2 and amortized over a specified period. Without specific authorization from the Commission in its Final Order in this case, the Company would be required to record a write-off when it becomes probable and estimable that: (1) all or part of the undepreciated investment in Units 2 and 3 will not be recovered; or (2) partial or no return on the undepreciated investment in Units 2 and 3 will be provided. Mr. Horn's testimony addresses the significant negative impacts a write off would have on PNM's financial condition. Mr. Darnell and Mr. Ortiz discuss why, from a regulatory policy perspective, providing for recovery of this undepreciated investment is in the public interest.

Q. IS THE COMPANY ALSO REQUESTING A CARRYING CHARGE ON THE UNDEPRECIATED INVESTMENT?

A. Yes. Due to the time value of money a fully compensatory carrying charge, or return, is necessary to assure that PNM has an opportunity to recover the full amount of the undepreciated investment. Accordingly, the Company is requesting a carrying charge at its pre-tax weighted average cost of capital on its undepreciated investment. This would be no different from the return the Company is receiving today. As explained by Mr. Horn, the investment in SJGS Units 2 and 3 were financed by a mix of debt and equity. The only difference, as pointed out in Mr. Monroy's testimony, is the twenty year time period the Company is requesting for recovery of its undepreciated investment. Mr. Monroy quantifies the revenue requirement associated with this treatment of the undepreciated investment in his direct testimony.

Q. IS THE RECOVERY OF THE UNDEPRECIATED INVESTMENT THE RECOVERY OF AN EXPENSE FOR ACCOUNTING PURPOSES?

A. Yes. For accounting purposes, the Company will amortize the undepreciated investment over a twenty year period and will record an annual expense of 1/20th of the undepreciated investment in its income statement. In the absence of the accounting order I have described, the undepreciated investment would be written off in one year. Essentially that means that the remaining investment would flow through the income statement as an expense all in one year. However, it would not be reasonable to attempt to recover this large of an expense from customers all in one year. Therefore, PNM is proposing to amortize the undepreciated investment over twenty years.

Q. WHY IS PNM PROPOSING TO RECOVER THE UNDEPRECIATED INVESTMENT OVER TWENTY YEARS?

A. As with other large expense items, it is appropriate to record the expense as a regulatory asset and amortize it over an extended period of time in order to mitigate the impact of the cost on customers. Absent the retirement of SJGS units 2 and 3, the remaining depreciable life of the units would have been 36 years (2018 – 2053). However, it would not be reasonable to use this service life for the amortization period of the regulatory asset since the plant will no longer be in service and the longer amortization period would increase the amount of carrying costs that have to be collected from customers. On the other hand, a recovery period of less than twenty years would result in higher annual revenue requirements and rate impacts on customers that could be considered unacceptable. The twenty-year recovery period balances customer and shareholder interests.

Q. WHAT WOULD BE THE REQUIRED ACCOUNTING TREATMENT IF THE COMPANY WERE DENIED THE OPPORTUNITY TO RECOVER A FULL RETURN ON THE UNDEPRECIATED INVESTMENT IN SJGS UNIT 2 AND 3?

A. ASC 980-360-35-3b (formerly SFAS 90) states that any disallowance of all or part of the costs of the abandoned plant, including a return, shall be recognized as a loss. In the event the Company was allowed a return of, i.e., recovery of the costs through the twenty year amortization, but not a return on its investment, the

Company would be required to determine the present value of future revenues under that ratemaking treatment, would record that amount in FERC Account 182.2 as a regulatory asset, and would record the difference between the amount of the regulatory asset and the undepreciated investment as an impairment loss in FERC Account 435. This accounting treatment recognizes the economic principle of the time value of money. Essentially, if cost recovery is deferred over a period of time, failure to apply a compensatory carrying charge during that period results in an inability to fully recover the amount of the expense and an impairment loss must be recorded. As Mr. Horn indicates, any impairment loss associated with the retirement of SJGS Units 2and 3 will be viewed unfavorably by credit rating agencies and will have a negative financial impact on PNM.

III. PVNGS UNIT 3

Q. WHAT TOPICS WILL YOU ADDRESS IN THIS SECTION OF YOUR DIRECT TESTIMONY?

A. In this section of my direct testimony, I will address the regulatory history of PVNGS Unit 3, including its abandonment and decertification by the New Mexico Public Service Commission ("NMPSC") in NMPSC Case No. 2285. I will also address the significant write-down of the book value of this facility that the Company was required to take in 1992 following the decertification, and will describe the accounting treatment for including PVNGS Unit 3 in jurisdictional rates at a cost higher than its net book value.

Q. PLEASE DESCRIBE THE REGULATORY HISTORY OF PVNGS UNIT 3.

A. In anticipation of rapid retail load growth in PNM's service territory, the Company along with several other utilities entered into the Arizona Nuclear Power Project ("ANPP") in 1973 for the purpose of constructing PVNGS. PNM filed a petition for a CCN with the NMPSC in 1975 after the NMPSC determined that a CCN was required, and was granted a CCN for its interest in PVNGS Units 1, 2 and 3 in Case No. 1216 on February 8, 1977. Construction of PVNGS Unit 3 was completed in 1988, at which time, due to much slower than anticipated retail load growth, the Company was faced with a significant amount of excess generating capacity. In turn, the NMPSC docketed Case No. 2146, Part II, to address the excess capacity issue. In the Final Order in that case, the Commission permanently excluded PVNGS Unit 3 from PNM's rate base and directed PNM to propose an appropriate disposition of PVNGS Unit 3, in view of the permanent rate base exclusion. In 1990, in Case No. 2285, the NMPSC decertified PVNGS Unit 3, permanently relinquishing all regulatory authority over PNM's interest in that plant.

Q. WHAT WAS THE ACCOUNTING IMPACT OF THE COMMISSION'S EXCLUSION OF PVNGS UNIT 3 FROM JURISDICTIONAL RATES?

A. As a result of PVNGS Unit 3 being decertified and permanently excluded from jurisdictional rates, the Company evaluated options to reduce the amount of, and costs associated with, its excess generating capacity. In 1993, PNM announced its decision to attempt to sell PVNGS Unit 3. That decision triggered a GAAP requirement to revalue PVNGS Unit 3 on PNM's balance sheet based on the plant's estimated value in the market place, and resulted in PNM having to record an impairment loss of $181.3 million. Had PVNGS Unit 3 remained subject to cost of service regulation, no such impairment loss would have been recorded.

Q. IF THE COMMISSION RECERTIFIES PVNGS UNIT 3 AS A JURISDICTIONAL RESOURCE AT THE VALUE PROPOSED BY MR. DARNELL, ARE THERE ANY ACCOUNTING OR REGULATORY CONSIDERATIONS THAT NEED TO BE ADDRESSED?

A. Yes. The Company would be required, under GAAP and FERC requirements, to record the transaction at fair value, which would require the Company to write-up the value of PVNGS Unit 3 from its projected net book value of $143,447,783 at December 31, 2017, to the $335.0 million value discussed in the testimonies of Mr. Darnell and Mr. Reed.

IV. <u>OTHER ACCOUNTING MATTERS</u>

Q. ARE THERE ANY OTHER ACCOUNTING MATTERS THAT YOU WISH TO DISCUSS?

A. Yes. PNM is requesting an accounting order, as part of this Application, authorizing certain costs incurred in compliance with the BART determination for SJGS under the FIP to be recorded as a regulatory asset on the Company's balance sheet for future recovery in a general rate case as reasonable and prudent expenses. Mr. Olson discusses these costs in more detail in his direct testimony.

PNM Exhibit TGS-2 is a summary of the costs incurred by the Company to comply with the FIP requirement as of November 30, 2013.

Q. YOU STATE THAT THE COSTS INCLUDED IN PNM EXHIBIT TGS-2 ARE THROUGH NOVEMBER 30, 2013. WILL THE COMPANY INCUR ANY ADDITIONAL COSTS RELATED TO COMPLIANCE WITH THE FIP?

A. No. There will be no additional costs associated with the Company's compliance with the FIP, assuming all regulatory approvals needed to implement the Revised SIP are granted.

Q. IF THE COMMISSION AUTHORIZES THE RECOVERY OF THE COSTS INCLUDED IN PNM EXHIBIT TGS-2 WHEN WOULD PNM SEEK RECOVERY OF THESE COSTS?

A. PNM would propose to include recovery of these costs in its next general rate case filing before the NMPRC.

Q. HAS THE COMPANY INCURRED ANY LITIGATION RELATED COSTS ASSOCIATED WITH THE FIP AND PURSUING DIFFERENT BART ALTERNATIVES, OR INCREMENTAL COSTS ASSOCIATED WITH THIS FILING? IF SO, IS THE COMPANY REQUESTING APPROVAL FROM

THE COMMISSION FOR RECOVERY OF THESE COSTS IN A FUTURE RATE CASE?

A. The Company has incurred litigation related costs associated with the FIP and evaluating and pursuing different BART alternatives. In addition, the Company will incur incremental costs associated with this filing and costs associated with the amendment of the San Juan Project Participation Agreement necessary to facilitate the retirement of SJGS Units 2 and 3 and the 78 MW ownership exchange from Unit 3 to Unit 4. However, the Company is not requesting approval of these costs as part of this filing. The Company will propose recovery of these costs in its next general rate case and will provide justification for approval of these costs in that case.

V. CONCLUSIONS

Q. DO YOU HAVE ANY CONCLUDING OBSERVATIONS?

A. Yes. As discussed in the testimony above, a Commission order authorizing PNM to record the undepreciated investment associated with the retirement of SJGS 2 and 3 as a regulatory asset on its balance sheet with a fully compensatory carrying charge is critically important. Absent such an order, the Company will be faced with significant balance sheet write-offs which would have serious negative consequences for PNM and PNM's customers as discussed by Mr. Horn.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

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