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NEW APPLICATION

BEFORE THE ARIZONA CORPORATION

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IN THE MATTER OF APPROVAL ARIZONA PUBLIC SERVICE'S APPROVAL OF ITS DEMAND SIDE MANAGEMENT PROGRAM PORTFOLIO PLAN UPDATE 2008-2010	Docket No. **E-01345A-07-0712** **NOTICE OF FILING**

Arizona Public Service Company ("APS" or "Company"), hereby files its Demand Side Management Program Portfolio Plan Update 2008-2010 ("DSM Portfolio Plan Update"). This DSM Portfolio Plan Update provides an overview of the continuation of APS' DSM programs that were originally filed July 21, 2005 and were implemented during 2005 through 2007.

The DSM Portfolio Plan Update specifically provides an update to APS' residential and non-residential programs, description and request for approval of its DSM budget, description of estimated program energy savings and benefits, as well as a proposal for portfolio enhancements. Specifically, APS is requesting the following:

- Approval of overall program spending of $76.5 million[1] for the 3-year period 2008-2010.
- Approval of program specific budget levels for the same 3-year period.
- Approval of additional program flexibility to include:
  - Shift up to 50% of funding between programs within a sector;
  - Change financial incentive payments up to 100% of incremental costs; and
  - Change measure minimum efficiency requirements, as needed.

[1] The $76.5 million includes $18 million of the $48 million that was authorized in Decision No. 67744, but has not yet been spent due to the timing of program approvals.

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- Clarification to confirm that the rebates and incentive cap of 52% of overall budget for Non-Residential programs expires at the end of 2007.
- Clarification that APS can shift funding between measures within a program without prior approval by the Commission.
- Approval of an increase in start up costs for Tribal Low Income Weatherization program from 20% to 30% of total program costs.

Consistent with Decision No. 67744, APS is obligated to spend $16 million per year on energy efficiency DSM Programs during calendar years 2005 - 2007. In August of 2007, the Commission in Decision No. 69879 ordered an additional $3.5 million to be designated for the non-residential large existing facilities program. Decision No. 69663 clarified the requirement that if APS does not spend at least 30 million of the base rate allowance for approved and eligible DSM programs during 2005-2007, any unspent amount should be credited to the balance of the DSM adjustment clause. In compliance with Decision Nos. 67744 and 69663, APS will have spent in excess of $30 million on DSM by year end 2007.[2]

To ensure that APS reaches the spending levels agreed to in Decision No. 67744, APS proposes to ramp up DSM spending for the years 2008 through 2010 and expects to spend at an annual level of $25.5 million per year for 2008 through 2010.[3]

In addition, APS seeks approval of the individual program budgets for 2008 through 2010 as set forth in the DSM Portfolio Plan. APS also seeks the Commission's approval to provide APS additional flexibility in managing its portfolio programs to allow a shifting of budget dollars between programs to obtain the most efficient use of DSM dollars, increase pay incentives, and modify energy efficiency requirements as needed.

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[2] $30 million is an estimate, the actual spending for 2007 will be available in January 2008 and it will be reported in the Company's annual DSM Adjustor filing.

[3] The $25.5 million represents the annual required spending of $19.5 million (the original $16 million per year plus an additional $3.5 million approved in August of 2007), plus approximately $6 million per year or $18 million to complete the 2005/2007 spending of $48 million pursuant to Decision No. 67744.

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In addition, APS is seeking clarification from the Commission as to whether pre approval is needed to shift funding between measures within a program and approval to increase start up costs for Tribal Low Income Weatherization.

RESPECTFULLY SUBMITTED this 28 day of December, 2007.

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APS
Demand Side Management Program Portfolio Plan Update 2008-2010

12/28/07

TABLE OF CONTENTS

I. Request Summary ---------- 3

II. Introduction ---------- 3

III. DSM Portfolio ---------- 5

IV. Residential Programs ---------- 6

A. Residential New Construction ---------- 6

B. Residential Existing Homes Heating, Ventilation, and Air Conditioning ("HVAC") 6

C. Consumer Products ---------- 7

D. Low Income ---------- 8

V. Non-Residential Programs ---------- 9

A. Non-Residential Existing Facilities ---------- 9

B. Non-Residential New Construction ---------- 10

C. Small Business ---------- 10

D. Schools ---------- 10

E. Building Operator Training ---------- 11

F. Energy Information Services ---------- 11

VI. Budget ---------- 12

VII. Program Energy Savings and Benefits ---------- 14

VIII. Portfolio Enhancements ---------- 16

A. Flexibility ---------- 16

B. DSM Performance Incentive ---------- 17

C. Requests for Clarification ---------- 18

I. Request Summary

In this filing, APS is requesting the following:

- Approval of overall program spending of $76.5 million for the 3-year period 2008-2010.
- Approval of program specific budget levels for the same 3-year period.
- Approval of additional program flexibility to include:
  - Shift up to 50% of funding between programs within a sector
  - Change financial incentive payments up to 100% of incremental costs, as needed
  - Change measure minimum efficiency requirements, as needed.
- Clarification to confirm that the rebates and incentive cap of 52% of overall budget for Non-Residential programs expires at the end of 2007.
- Clarification that APS can shift funding between measures within a program without prior approval by the Commission.
- Approval of an increase in start up costs for Tribal Low Income Weatherization program from 20% to 30% of total program costs.

II. Introduction

This Demand Side Management ("DSM") Program Portfolio Plan Update ("Plan Update") provides an overview of the continuation of the DSM programs that were originally filed with the Arizona Corporation Commission ("ACC") in July 2005 and were implemented during 2005 through 2007. The original 2005–2007 DSM Portfolio Plan met the requirements of the 2005 settlement agreement ("Settlement"[1]) while providing savings and net benefits for APS customers. While the $30 million collected in base rates for DSM funding will have been spent on DSM by the end of the 2005-2007 time period, due to the timing of program approvals, the commitment to expend the full $48 million by the end of 2007 will not be met.

APS is committed to a cost effective DSM program portfolio beyond 2007. This Plan Update provides an overview of APS' plan to fulfill the $48 million DSM expenditure requirement. Moreover, this update assumes the continuation of these existing programs and proposes a new budget guideline for the 2008 – 2010 timeframe.

APS is requesting approval of overall program spending of $76.5 million for the 3-year period 2008-2010, an average annual level of $25.5 million. The $25.5 million represents annual spending of $19.5 million ($16.0 million per year plus the additional $3.5 million approved in Decision No. 69879) plus approximately $6.0 million per year to expend the $18 million remaining from its DSM spending obligation under the Settlement. As part of its Decision No. 67744, the ACC required APS to implement and maintain a collaborative DSM working group to solicit and facilitate stakeholder input, advise APS on program implementation, develop future DSM programs, and review DSM program performance. This Plan Update was developed and continues to be enhanced in conjunction with this

[1] The Settlement was adopted in Commission Decision No. 67744 (April 7, 2005).

collaborative group of DSM experts and stakeholder representatives, including members of ACC staff, the Residential Utility Consumer's Office ("RUCO"), the Southwest Energy Efficiency Project ("SWEEP"), Western Resource Advocates ("WRA"), the Department of Commerce Energy Office ("the Energy Office"), Arizonans for Electric Choice and Competition ("AECC") and others.

Subsequent to APS filing the original DSM program portfolio plan in July 2005, the ACC approved the Consumers Products program in August of 2005 in Decision No. 68064 (Aug.17, 2005). The ACC's interim approval of the Non-Residential programs from Decision No. 68488 (Feb. 23, 2006) was contingent upon a refiling of the Non-Residential programs within 13 months of that Decision. The 13-Month Filing report was filed on March 26, 2007 in Docket No. E-01345A-05-0429. The objective of that filing was to achieve final approval of the APS Non-Residential DSM programs.

As part of the 13-Month Filing report, APS recommended a number of program enhancements. These program enhancements will encourage more customers to participate in energy efficiency projects, especially in those harder to reach segments, such as small businesses. All additional measures and program enhancements were thoroughly analyzed by APS and were found to be cost effective. For more information on these suggested program enhancements, see the 13-Month Filing Report. While ten of the thirteen requested changes in the 13-Month Filing Report are still pending approval by the ACC, this Plan Update assumes that all program enhancements requested in that filing will be approved. The specific enhancements recommended in the 13-Month filing will not be discussed in detail again here, but reference will be made to the details included in that filing.

The balance of the original portfolio plan (balance of Residential programs; Measurement, Evaluation, and Research; and the Performance Incentive) was approved in Decision No. 68648 (Apr.12, 2006).

This Plan Update provides an average annual budget guideline, estimates of energy and demand savings, and a societal net benefits projection for the DSM programs for the 2008–2010 planning horizon. It is important to note that the average annual budget contained in this filing is merely a guideline of total expenditures over the three year period 2008–2010. It cannot be expected that the expenditures in each of the three years will exactly match the average annual amount suggested in this filing. APS' DSM programs are still in the growth phase of the program adoption curve. In other words, we expect the total portfolio expenditures to increase each year over the three year period, just as they have in the prior three years. Ultimately, customer awareness, acceptance, and adoption of our programs will dictate the exact expenditure levels each year. The average annual budget proposed in this Plan Update represents our most realistic assessment of the demand for the Company's DSM program over the next three years. As with any estimate of the future, the possibility exists that actual annual expenditures will be either higher or lower than the average annual budget contained in this filing.

III. DSM Portfolio

APS proposes to continue to implement a portfolio of energy-efficiency DSM programs that reduce the use of electricity by means of energy-efficiency products, services or practices. The programs are designed to influence energy decisions by Residential and Non-Residential customers and other market players through a combination of rebates and incentives, technical assistance and training, and consumer education.

The DSM program portfolio is expected to continue to produce long-term energy consumption and demand savings. For the 2008–2010 timeframe, the program cost is expected to be 1.1 cents per lifetime kWh saved (total kWh saved over the expected lifetime of all installed measures). The following table summarizes the expected energy and demand savings and total program net benefits as a result of program activities from 2008-2010.

Exhibit 1
DSM Portfolio Goals 2008-2010

Program Budget 2008-2010	Lifetime MWh Savings*	Peak Demand Savings (MW)	Total Net Benefits*
$76.5 Million	**6,814,000**	**109.9**	**$187 Million**

**Refers to savings and total net benefits over the expected lifetime of all program measures installed in 2008-2010. The Total Net Benefits estimate incorporates all program costs including the cost of Measurement, Evaluation & Research and Performance Incentives. Note however, that net lost revenues are not included in these costs.*

These benefits will be in addition to the benefits achieved in the 2005 through 2007 time frame, which are not included in the estimated impacts in Exhibit 1. For more detail on the savings and net benefits achieved during the 2005-2007 timeframe, see the Company's DSM semi-annual report filings.

For the period of 2005 – 2010, the DSM programs are estimated to save approximately 168 MW and 9.9 million lifetime MWh.

The program portfolio continues to include a balanced mix of programs to address a diversity of APS customer segments and market opportunities including: residential existing homes, residential new construction, consumer products, non-residential existing buildings, non-residential new construction and renovation, and small business. In addition, the portfolio continues to provide special programming and funding to help schools and low-income residential customers, including Native Americans, save on their energy costs.

Sections IV (Residential Programs) and V (Non-Residential Programs) outline the expectations for the continuation of our existing programs and contain projections for future participation levels. Section V provides the average annual budget for 2008 – 2010, while Section VII summarizes the estimated program savings and net benefits, and Section VIII discusses some suggested portfolio enhancements.

IV. Residential Programs

A. Residential New Construction

This program promotes high efficiency construction practices for new homes. It offers incentives to builders who meet program energy efficiency standards in order to increase the penetration of high efficiency homes. The program emphasizes the "whole building" approach to improving energy efficiency and includes field testing of homes to ensure performance. Participating builders are trained to apply building science principles to assure that high-efficiency homes also have superior comfort and performance. The program also provides education for prospective homebuyers about the benefits of choosing an energy-efficient home and the features to consider.

The APS Residential New Construction program has been a success, with over 25 participating builders and over 20,800 homes signed up to be built to program standards since the program was kicked off in July 2006. Program spending as of October 31, 2007 is over $1.7 million in the 16 months since program inception. The annual average spending budget for 2008 – 2010 is $1.8 million. This budget level reflects both the lag in the timing between builders' commitments and when incentives are paid and a slow-down in the Phoenix area housing market that is expected to rebound somewhat by 2009. Incentives will be paid on approximately 1,200 homes in 2007, and APS expects to pay incentives on 2,500 homes in 2008, 3,000 homes in 2009, and 3,500 homes in 2010. Despite the slowdown in the housing market, the annual increases in expected incentives reflect the increased number of builders signing up for the program and the eventual build out of those homes already committed to the program.

B. Residential Existing Homes Heating, Ventilation, and Air Conditioning ("HVAC")

The residential existing home HVAC program promotes energy-efficient equipment and proper installation and maintenance of residential heating and air conditioning systems. The program provides training and technical assistance for HVAC contractors and education for consumers about the benefits of energy-efficient heating and cooling systems. Through the APS Qualified Contractor program, APS provides customer referrals to contractors who meet strict program requirements for professional standards, technician training and customer satisfaction. This program uses a combination of financial incentives, contractor training and consumer education to promote high efficiency HVAC systems in existing residential homes within the APS service territory.

The AC Rebate and Quality Installation measures build on the existing APS Qualified Contractor program. They offer financial incentives to encourage upgrades to high-efficiency equipment (≥14 SEER/11.5 EER) that exceeds US EPA/DOE Energy Star® energy-efficiency standards, plus an additional incentive if that equipment is installed so that it meets the program requirements for air flow, refrigerant charge and sizing. Also, beginning in the winter of 2007, the HVAC System Testing and Repair measure will be launched to provide financial incentives for customers having HVAC equipment repairs to also have home performance tests with associated system repairs, such as sealing duct system leaks.

As of the end of October 2007, $2.9 million was spent on the program, out of a total three year budgeted amount of $3.5 million. Currently, APS estimates that by the end of 2007, the program will be within $300,000 of the budgeted spending amount. Since its inception in the spring of 2006, this program is tracking close to the budgeted amounts for spending and savings and continues to gain momentum.

For the 2008 – 2010 budget, APS plans to increase the program's budget to an annual average of over $2.8 million. This is a $982,000 increase over the 2007 program budget. Approximately, 3,000 incentives will be paid in 2007 and an estimated 5,800 in 2008, 6,400 in 2009 and 7,000 in 2010. The budget increase is required to allow the momentum of the program to continue and also accommodate the newer Quality Installation and HVAC System Testing and Repair measures.

C. Consumer Products

The primary target market for the Consumer Products program is APS residential customers who are looking to purchase lighting. This program is being implemented through participating retailers within the APS service territory and is available to all APS residential customers.

This program promotes high-efficiency EPA/DOE Energy Star® approved lighting. The program solicits discount pricing from Compact Fluorescent Lamp ("CFL") manufacturers (up-stream buy-down) and distribution of CFL's through local retailers. Customers are referred to participating retailers to purchase qualifying products. Discount pricing is passed on to consumers through a negotiated agreement with lighting manufacturers and retailers. The program provides sales training for participating retailers and consumer education, including in-store point-of-sale displays.

There have been over 3.8 million CFL's sold through this program as of October 31, 2007, which has generated over $150 million in customer savings. Program spending is over $5.3 million through October 31, 2007. Due to the high degree of success from this program the annual average 2008 – 2010 budget is being increased to $4.1 million. This level of funding assumes sales in excess of 2.5 million CFL's per year. It also covers anticipated expenses associated with an effort to encourage proper CFL recycling and disposal and it includes a more diverse mix of specialty CFL's to accommodate a wider variety of residential lighting end use applications (i.e. recessed can light reflector bulbs, globe style bulbs, etc.) APS expects to continue to expand and promote this program to continue its success.

D. Low Income

The APS Energy Wise Low Income Weatherization Program (Energy Wise) began in 1996. Decision No. 68647 that was issued on April 12, 2006 has spurred program growth and it has ramped up to serve a larger number of customers. Additionally, the program has expanded its scope to include working with local low income public housing authorities, which has resulted in some high volume weatherization efforts. One such project, the Maricopa County Housing Authority's Buckeye Manor, resulted in the weatherization of 20 units. Additionally the Arizona Community Action Agency (ACAA) was awarded a contract from the Arizona Department of Economic Security to develop and implement a statewide Fuel Fund that will be used to provide energy related bill assistance to customers in need. In support of that effort, a proposal was made by ACAA and accepted by APS to allocate the APS Energy Wise Low Income Weatherization Bill Assistance funds to the ACAA Fuel Fund in order to take advantage of the leverage for matching dollars from the Fuel Fund.

Additionally, APS has been actively working with the Inter Tribal Council of Arizona and the Navajo Nation Weatherization Program to implement the Energy Wise Program. However, there are some start-up cost issues that need to be addressed. Specifically, since the Tribal Weatherization efforts are in startup mode, they will require additional program delivery funds to pay for startup costs. After several budget reviews with the Tribes, it is clear that increasing the program delivery cost share of total program costs from 20% to 30% during start-up is reasonable. The additional 10% that could be used for program delivery costs would only be in place for the first two years of the program. Thereafter, the standard program delivery share of 20% of total program costs would take effect.

The budget for the Energy Wise program is being increased from $1.1 million per year to approximately $1.5 million per year in 2008 - 2010. This increase reflects the catch-up spending in 2008 – 2010 that makes up for the 2005 – 2007 under-spending on this program.

V. Non-Residential Programs

The 13-Month Filing report was filed on March 26, 2007. The objective of the filing was to achieve final approval of the APS Non-Residential DSM programs, as required in Decision No. 68488. The Non-Residential Programs received interim approval from the ACC in February 2006 and these programs were launched in March 2006.

In addition to the existing measures, APS recommended a number of program enhancements in the 13-Month Filing Report, including the revision of some prescriptive measures and additional cost-effective measures. These program enhancements will encourage more customers to participate in energy efficiency projects, especially in those harder to reach segments, such as small businesses. All additional measures and program enhancements were thoroughly analyzed by APS and were found to be cost effective. These additional proposed measures are currently awaiting ACC approval. For more information on these suggested program enhancements, see the 13-Month Filing Report.

The Non-Residential programs are marketed under the APS Solutions for Business program. Other than the two small programs (Energy Information Services and Building Operator Training), the programs (Non-Residential Large Existing, New Construction, Small Business, and Schools) are implemented by KEMA, APS' Non-Residential program implementation contractor. Budget projections for each of the programs are based on recent experience in the APS market place, expected customer program participation growth based on KEMA's experience in similar markets, and approval of all program enhancements suggested in the 13-Month Filing. A description of each of the Non-Residential programs follows.

A. Non-Residential Existing Facilities

The primary targets for the Non-Residential Existing Facilities Program are customers who have an aggregated demand greater than 200 kW. This program provides prescriptive incentives to owners and operators of large non-residential facilities for energy-efficiency improvements in lighting, HVAC, motors, and refrigeration measures. Custom incentives are also provided for energy-efficiency measures not covered by the prescriptive incentives. Incentives are also provided to customers for energy studies.

This program has had the strongest participation to date among the Non-Residential programs, with program-to-date spending of $5.3 million through October 31, 2007. We anticipate this program to continue to be our strongest program in participation and it will continue to grow with an annual average total budget of $6.9 million, compared to the 2005-2007 average annual budget of $2.3 million. This budget increase includes the additional $3.5 million that was granted by the ACC in August of 2007 (Commission Decision No. 69879).

B. Non-Residential New Construction

This program includes three components: design assistance, prescriptive measures, and custom efficiency measures. Design assistance involves efforts to integrate energy-efficiency into a customer's design process to influence equipment/systems selection and specification as early in the design process as possible. Custom efficiency provides incentives for large non-residential customers and provides feasibility studies to assess the savings from complex applications. Prescriptive incentives are available for energy-efficiency improvements in lighting, HVAC, motors and refrigeration applications.

As of October 31, 2007, total spending within this program was $2.1 million, which includes incentives paid of $240,000. Reserved incentives are currently at $674,000. Due to the nature of the new construction market place, program participation has been slower as compared to the Large Existing Facilities Program. However, we anticipate participation to grow in the next three years with annual average incentives to be $1.0 million and a total budget to be $2.0 million.

C. Small Business

The primary targets for the Small Business Program are customers who have 200 kW or less aggregated demand. This program provides prescriptive incentives to small business owners for energy-efficiency improvements in lighting, HVAC, motors and refrigeration applications through a simple and straightforward mechanism.

As of October 31, 2007, total spending within this program was $1,200,000 which includes incentives paid of $150,000. Reserved incentives are currently at $160,000. Small Business customers are the hardest to reach because they do not typically have the resources to evaluate or implement energy efficiency projects. For this reason APS recommended a direct install program in the 13-Month filing. A direct install program is where APS provides trade allies a direct incentive to implement lighting and refrigeration measures at customer facilities. This program addresses many of the small business barriers to entry by simplifying their buying decision and reducing the trade ally transaction costs. With the help of this direct install approach, we anticipate that the Small Business program will grow to $950,000 in incentives per year and an average annual budget of $1,400,000.

D. Schools

This program is designed to set aside funding for public school buildings, including charter schools, to participate in the APS Solution for Business programs. This program budget is reserved exclusively for school use. If schools fully subscribe this program budget or if they reach their incentive cap under this program, they can participate in other non-residential programs. Energy efficiency incentives are the same as the Large Existing Facilities (existing school facilities) and New Construction (new school construction and major renovations).

As of October 31, 2007, total spending within this program was $504,000 which includes incentives paid of $167,000. Reserved incentives are currently at $143,000. Due to lower customer incentive caps for the Schools program, as compared to the other programs, many of the incentive funds paid to schools have been booked to the other programs

(predominantly Large Existing Facilities). For the next three years, we estimate that the annual average incentives for schools to be $540,000 with a total annual average budget of $980,000.

E. Building Operator Training

The Building Operator Training Program ("BOT") provides training incentives for building operators (managers) and facility maintenance technicians on energy-efficient building operating and maintenance practices. Program training is provided through a cooperative effort with the Electric League of Arizona ("ELA") in support of their "Institute for Facility Management Education" program, which includes industry expert training targeted to reach facility managers and building operators of medium to large commercial and industrial facilities. Since inception, eighty-five APS customers have successfully received their certificate of completion for the program. We expect the average number of students per year to be 75 to 85 for the 2008–2010 timeframe, producing an annual average budget of $66,000.

F. Energy Information Services

The Energy Information Services (EIS) program provides 15-minute interval data to large non-residential customers through a web-based energy information tool. This tool provides customers with information that can be used to improve or monitor energy usage patterns, reduce energy use, reduce demands during on-peak periods and better manage their overall energy operations. This program is being implemented by Automated Energy, Inc.

This program is in the early stages of development, with EIS installed on approximately ten customer meters to date. Going forward we expect to install EIS on an average of 100 customer meters each year in the 2008–2010 time frame, producing an annual average budget of $120,000.

VI. Budget

Consistent with Decision No. 67744, APS intends to spend $16 million dollars per year on approved energy-efficiency DSM programs during 2008-2010. In August of 2007, Commission Decision No. 69879 approved an additional annual $3.5 million for the Non-Residential Large Existing Facilities Program. During the 2005–2007 planning period, APS intended to spend $48 million. At the point in time of this filing, it appears that APS will have spent in excess of $30 million on DSM for the 2005–2007 period, approximately $18 million less than the intended $48 million. This under spending should be remedied in the coming years. The exact amount spent in each year from 2008–2010 should be dictated by the market demand for these programs, not a fixed budget. However, the average annual spending for DSM over the 3-year planning period is expected to be:

	Avg. Annual
Original Decision No. 67744	$16.0 million
August 2007 Decision No. 69879	$ 3.5 million
Under Spending Catch-up	$ 6.0 million
Total Annual DSM Spending	$25.5 million

The proposed budget shows how APS will satisfy the remainder of the $48 million while continuing approved programs going forward.

A total of 67% of the program costs benefit customers directly in the form of incentives, training or education. It should be noted that other costs such as program implementation and marketing expenses are necessary to effectively deliver programs to customers.

Exhibit 2 shows a summary of the anticipated average annual spending for each program for the 2008-2010 planning horizon. This budget represents the most likely estimate of future spending at the $25.5 million average annual level. However, these projections are based on our best estimates of market penetration for each measure. To the extent that certain programs achieve greater success and market penetration than others, it is important to be able to adjust budgets between measures accordingly to maximize the effectiveness of the overall portfolio. See the "Program Flexibility" section of this filing for further discussion of APS' proposed flexibility guidelines.

Exhibit 2
2008-2010 DSM Portfolio
Average Annual Budget

Program	Rebates & Incentives	Training & Tech Assistance	Consumer Education	Program Implement	Program Marketing	Plan & Admin	Program Total Cost
Residential							
Consumer Products	2,500,000	1,000	15,000	1,295,000	146,000	104,000	**4,061,000**
Existing Home HVAC	1,711,000	68,000	140,000	420,000	414,000	48,000	**2,801,000**
New Construction	1,200,000	59,000	9,000	169,000	302,000	79,000	**1,818,000**
Low Income	1,366,000	10,000	10,000	96,000	10,000	75,000	**1,567,000**
Totals for Residential	**$ 6,776,000**	**$ 138,000**	**$ 174,000**	**$ 1,980,000**	**$ 872,000**	**$ 306,000**	**$ 10,247,000**
Non-Residential							
Large Existing Facilities	4,790,000	20,000	14,000	1,283,000	562,000	182,000	**6,851,000**
New Construction	950,000	15,000	2,000	510,000	432,000	112,000	**2,021,000**
Small Business	947,000	10,000	12,000	220,000	106,000	68,000	**1,363,000**
Bldg Operator Training	0	41,000	2,000	11,000	6,000	6,000	**66,000**
EIS	89,000	5,000	2,000	6,000	10,000	10,000	**122,000**
Schools	540,000	5,000	6,000	253,000	145,000	31,000	**981,000**
Totals for Non-Residential	**$ 7,316,000**	**$ 96,000**	**$ 38,000**	**$ 2,283,000**	**$ 1,261,000**	**$ 409,000**	**$ 11,403,000**
Segment Totals	**$14,092,000**	**$ 234,000**	**$ 212,000**	**$ 4,263,000**	**$ 2,133,000**	**$ 715,000**	**$ 21,650,000**
% of Cost By Category	**65.1%**	**1.1%**	**1.0%**	**19.6%**	**9.9%**	**3.3%**	

Program Costs	**$21,650,000**
Measurement, Evaluation & Research	**$1,300,000**
Performance Incentive	**$2,550,000**
TOTAL	**$25,500,000**

VII. Program Energy Savings and Benefits

The Company has projected the estimated energy savings, costs and net benefits associated with each of the programs in the DSM Portfolio for the period of 2008-2010. For the analysis of net program benefits, the Company uses the most recent utility system avoided cost savings (including capacity value, fuel and operations/maintenance savings, and transmission and distribution savings) that will result from the expected lifetime energy savings and peak demand reductions generated by each DSM program. The avoided costs used in this filing are the same as those used in the March 2007 13-Month filing.

Exhibit 3 on page 14 provides a table that details the expected lifetime energy savings and peak demand savings from each DSM program and a summary of the net benefits generated for the 2008–2010 time frame. These are in addition to energy savings, costs and net benefits achieved in the 2005–2007 timeframe, which have been reported in APS' semi-annual DSM report filings. The lifetime energy savings are the estimated savings that will result over the expected lifetime of all program measures. **It is anticipated that over the expected lifetime of all measures, the Portfolio will produce net benefits of $187 million from measures implemented in the 2008-2010 timeframe, with a total societal cost test benefit/cost ratio of 2.52** (societal benefits / societal costs = $310 million / $123 million).

Exhibit 3
DSM Electric Savings Benefits
2008 – 2010 Programs

	Capacity Savings MW	Lifetime[1] MWh Savings	Program Budget	Societal Benefits	Societal Costs	Net Benefits
Residential						
Consumer Products	43.7	2,016,000	12,182,000	$118,050,000	$23,175,000	$94,875,000
Existing Home HVAC	17.1	814,000	8,403,000	$34,407,000	$19,531,000	$14,876,000
New Construction	9.7	458,000	5,455,000	$28,458,000	$7,254,000	$21,204,000
Low Income[2]	0.9	39,000	4,700,000	$3,950,000	$3,950,000	$0[3]
Totals for Residential	**71.4**	**3,327,000**	**30,740,000**	**$184,865,000**	**$53,910,000**	**$130,955,000**
Non-Residential						
Large Existing Facilities	25.0	2,464,000	20,552,000	$91,135,000	$41,443,000	$49,692,000
New Construction	5.0	489,000	4,088,000	$17,925,000	$9,108,000	$8,817,000
Small Business	4.9	227,000	6,062,000	$6,430,000	$3,020,000	$3,410,000
Building Operator Training	0.4	45,000	198,000	$898,000	$353,000	$545,000
Energy Information System	0.4	50,000	367,000	$1,973,000	$628,000	$1,345,000
Schools	2.8	212,000	2,943,000	$7,030,000	$3,020,000	$4,010,000
Totals for Non-Residential	**38.5**	**3,487,000**	**34,210,000**	**$125,391,000**	**$57,572,000**	**$67,819,000**
Subtotal	**109.9**	**6,814,000**	**$64,950,000**	**$310,256,000**	**$111,482,000**	**$198,774,000**
Measurement, Evaluation & Research			$3,900,000		$3,900,000	($3,900,000)
Performance Incentive			$7,650,000		$7,650,000	($7,650,000)
Total	**109.9**	**6,814,000**	**$76,500,000**	**$310,256,000**	**$123,032,000**	**$187,224,000**

1. *Refers to savings over the expected lifetime of all program measures.*
2. *Program costs include weatherization and bill assistance. Societal Costs do not include bill assistance because it does not contribute to electric savings.*
3. *Consistent with ACC Staff's analysis in Decision No. 68647, the societal benefits are equal to the societal costs.*

All MWh values are rounded to the nearest 1,000 and monetary values are rounded to the nearest $1,000.

VIII. Portfolio Enhancements

A. Flexibility

The majority of the APS DSM programs are still in the early stages of their growth. During the early stages of a program there are often unexpected challenges encountered and also practical knowledge gained that lead to program improvements and adaptations to a specific market. Additionally, as a program matures the market will also change. This is especially true if the programs are very successful. These situations require the ability to alter facets of a program's parameters, delivery or other details to maintain momentum and acceptance.

Review and formal approval of changes to DSM programs requires significant ACC Staff resources. To address this potential regulatory burden and provide for timely enhancements to improve program effectiveness without changing the scope of the programs, APS proposes that the ACC allow the Company to make the following modifications to its DSM programs without formal review and approval.

1. Shift up to 50% of funding between programs within a sector. An example would be moving funding from the New Construction program into the Consumer Products program. If the housing market slowdown is more dramatic during 2008 than expected, the requests for rebates in the New Construction program could slow as well. While the New Construction program has experienced strong support and acceptance from the builder community, rebates are not paid until the homes are constructed. The continued slowdown in the housing market may leave some funding available that could be moved to the very successful CFL measure that is a part of the Consumer Products program. Decision No. 68648, Pg. 4, Lines 3-5 set the limit for shifting funding at 25%. APS is requesting this limit be raised to 50% allowing increased ability to shift funds, as necessitated by changing market conditions. This would enhance the Company's ability to capitalize on a program's success. Funding would not be shifted between the residential and non-residential sectors or shifted out of the Low Income or Schools programs.

2. Change financial incentive payments up to 100% of incremental cost. Currently, there are requirements to limit financial incentives to either 50 or 75% of incremental cost, depending on the program. The ability to change the financial incentives allows APS to make adjustments that respond to the market. For example, because of the difficulties for Small Business to evaluate and fund energy efficiency projects, it is often difficult for them to take advantage of the DSM incentives available to them. An increase in the financial incentive that covers more of the incremental cost (through a direct install program as suggested in the 13 Month Filing) might help increase the participation in the Small Business program.

3. Change measure minimum efficiency requirements. Many of the DSM financial incentives are for equipment or services that are at the leading edge of energy efficiency technology and practice. The nature of such products and services is that they change relatively quickly. DSM programs based on these products and services

> have to adapt as well. The HVAC market is a good example of this. APS found that there were not many packaged air conditioners capable of keeping homes comfortable in this climate that meet the Existing Homes HVAC program minimum EER requirements. The ACC worked with APS and the EER requirements were lowered, but APS needed expedited treatment for the request, which placed an additional burden on the Staff. The flexibility to make such a requirement change without formal Commission approval would allow APS to minimize the lost opportunities these types of issues present.

APS recognizes that there should be reasonable parameters that guide these flexibility provisions. The Company proposes that the above changes would only be made if they adhere to the following requirements:

1. Prior notification and description of change would be provided to both the ACC and DSM Collaborative members.
2. Cost effectiveness is maintained. The results of the TRC must remain above 1.0.
3. The program's specified intent is not materially altered.
4. Funding is not shifted between Residential and Non-Residential programs or out of the Low Income or Schools programs.
5. Funding shifts would not cause Planning and Administration costs to exceed the caps set in the ACC orders which approved the programs.

Any new measures would still be submitted to the ACC for review and approval as they are now, in addition to significant budget changes and other major program changes. APS believes that some clearly defined flexibility will greatly assist in the long term success of energy efficiency in Arizona.

B. DSM Performance Incentive

The ACC approved a performance incentive based on the net economic benefits of energy-efficiency DSM in Decision No. 67744. See, Attachment A, paragraph 45 of that Decision, which states in part:

> APS will be permitted to earn and recover a performance incentive based on a share of the net economic benefits (benefits minus costs) from the energy-efficiency DSM programs approved in accordance with paragraph 41. Such performance incentive will be capped at 10% of the total amount of DSM spending, inclusive of the program incentive, provided for in this Agreement (e.g. $1.6 million out of the $16 million average annual spending referenced in paragraphs 40 and 44 or $4.8 million over the initial three-year period).

The incentive earned has been reported in each DSM semi-annual report filed with the ACC. The incentive has been determined for each reporting period based on the spending and net benefits reported for that period.

As DSM expenditures increase, alternatives to the existing Performance Incentive need to be considered. Without proper regulatory treatment, DSM programs can lead to significant

under recovery of utility costs and can erode earnings below authorized rate of return levels. When a customer participates in a DSM program, that customer will consume less energy than they would without the program. The customer continues to receive the same benefit from the energy provided, but ultimately pays less money than they would have otherwise. Because utilities primarily charge customers by the kilowatt-hour, DSM programs result in a lost revenue margin to the utility. That lost margin was intended to cover fixed costs (e.g. generation, distribution and customer service infrastructure costs) that cannot be avoided in the short-run and also provide a portion of the utility's return.

APS appreciates the value of DSM and wants to maximize its benefits to customers. Before it can do so, however, APS believes it should be assured that its financial condition will not suffer as a result and that it can cover its reasonable costs of doing business. As the DSM budget expands, so does the potential for significant lost revenues and decreased earnings. APS is currently evaluating the financial impact of increased DSM spending and will be seeking key stakeholder input and ACC approval of alternative mechanisms that will assure timely recovery of program costs, not penalize the company and provide the proper incentives to continue beneficial DSM programs.

C. Requests for Clarification

APS is requesting clarification on the following two issues. Decision No. 68488[2], requires that "... the combined expenditure for Rebates and Incentives for the Non-Residential programs from 2005 to 2007 be capped at the current estimated level, which is 52% of the overall budget. APS believes this requirement expires at the end of 2007. APS is requesting the ACC to confirm that this provision does indeed expire at the end of the year. If the ACC finds that this is not the case, then APS requests that the 52% cap on incentive spending to overall budget be removed. In Decision No. 69879, the 52% cap was addressed in the context of the Large Existing Facilities program and APS was specifically granted a waiver of this requirement. Staff position on this issue was addressed in that Decision, specifically, Staff stated that: 1) the purpose of this requirement was to ensure that the nature of the non-residential programs and their incentives would not be changed without ACC approval in the early years of the program; 2) that it appeared that APS has implemented and managed the non-residential existing DSM program in accordance with Commission guidelines; and 3) because most of the implementation costs have been borne, a higher percentage of overall program costs for rebates and incentives was now appropriate[3]. APS agrees with Staff and also feels this is appropriate for all of the other DSM programs. Therefore, APS believes the 52% cap is no longer necessary.

Second, APS is requesting clarification that it can shift funding between measures in the same program without notification to, or approval from, the Commission. This issue was discussed during the Nov. 27, 2007 Open Meeting regarding Docket No. E-01345A-05-0429. At this time, it is not clear if such a shift in funds is within APS' power or whether the Commission just approved this type of funding shift only in the limited context of that docket.

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[2] Pg. 5, Lines. 3-5.
[3] Decision NO. 69879, pgs. 6 – 7.