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June 3, 2009

Mr. Ernest G. Johnson, Esq.
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Arizona Corporation Commission
1200 West Washington Street
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Arizona Corporation Commission
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AZ CORP COMMISSION
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Re: Arizona Corporation Commission
Docket Nos. E-00000J-08-0314 & G-00000C-08-0314

Dear Mr. Johnson:

Pursuant to the request of the Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission"), attached please find the initial draft of proposed rules for Energy Efficiency funding, programs and standards ("the proposed EE Rules") prepared by UniSource Energy Corporation ("UniSource Energy"), Tucson Electric Power and UniSource Energy Services (collectively "the Companies"). As evidenced by their participation in this filing and the related dockets, the Companies fully support the Commission's efforts to enhance energy efficiency in Arizona. The Companies look forward to continued participation in the rulemaking process to ensure that final rules are fair, realistic, economically sound and in the public interest.

This first draft of EE Rules was modeled after the rules proposed by Staff in Docket No. RE-00000C-05-0230.¹ The Companies have modified the prior rules to reflect the new circumstances that have arisen since 2005 including the development of new energy efficiency, demand-side management and renewable energy programs and standards.

Notwithstanding the positions stated by various parties in these dockets, before final rules are promulgated, the following issues, at a minimum, need to be addressed and resolved:

- Recovery of utilities' costs and margin losses;
- Incentive programs;
- The definition of "cost effective" programs;
- A process to review the efficacy and economic impact of the proposed EE Rules; and

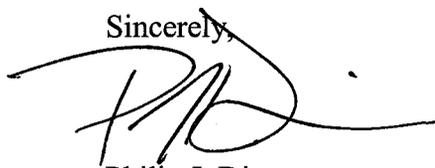
¹ The Companies respectively request that Docket No. RE-00000C-05-0230 be consolidated with the dockets in this matter at the appropriate time.

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- The relationship between these EE Rules, the Commission's REST and any potential Federal renewable energy and/or efficiency standards.

Again, we look forward to working with you, your Staff and interested parties in finalizing the EE Rules. If you have any questions, please do not hesitate to contact either David Hutchens, Vice President of Energy Efficiency and Resource Planning, or myself.

Sincerely,

A handwritten signature in black ink, appearing to be 'PJD', with a long horizontal flourish extending to the right.

Philip J. Dion

PJD:mi

cc: Docket Control (Original and 15 copies)
David Hutchens

UniSource Proposed Rules

ENERGY EFFICIENCY RESOURCE STANDARD

R14-2- XXX1 Applicability

R14-2- XXX2 Definitions

R14-2-XXX3 Goals and Objectives

R14-2-XXX4 DSM/EE Portfolio Plans and Programs

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R14-2-XX12 Other Approaches to DSM/EE

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R14-2- XXX1 Applicability

The purpose of these rules is to establish an Energy Efficiency Resource Standard (EERS) which shall govern the advancement and implementation of cost-effective and prudent demand-side management initiatives for all electric and natural gas utilities subject to the jurisdiction of the Commission that are classified as Class A according to A.A.C. R14-2-103(A)(3)(q).

R14-2- XXX2 Definitions

The following definitions apply to these rules:

- (1) "Amortization": the gradual cost recovery of expenditures for DSM programs, in regular payments over a specified period of time. Such payments may include both principal and carrying cost.
- (2) "Audit": a facility or home energy audit to assess how much energy the facility or home consumes and to evaluate measures to make the facility or home more energy efficient.
- (3) "Benefit/cost ratio": the ratio of the present value of benefits to the present value of costs.
- (4) "Conservation": steps designed to change individual customer behavior that will result in its reduction of energy consumption.
- (5) "Cost effectiveness test": an analysis using the "Total Resource Cost ("TRC")" that used to assist in the approval process of DSM Programs. A TRC Test result greater than one (1) shall be presumed to be cost effective.
- (6) "Demand Response": the ability to provide peak load capacity through demand management (load control) programs. This methodology focuses on curtailment of loads during peak demand times.
- (7) "Demand side management" (DSM): the planning, implementation, and evaluation of programs to shift peak load to off-peak hours, to reduce peak demand ("kW"), and/or to reduce energy consumption ("kWh" or "therms") in a cost-effective manner. DSM may include energy efficiency, load management, and demand response.
- (8) "DSM education": efforts by a utility to increase general awareness of DSM. DSM education programs shall not be subject to independent cost-effectiveness requirements.
- (9) "DSM period": the effective period of the DSM plan.

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- (10) "DSM program" : a Commission approved program that is aimed at influencing and reducing natural gas or electricity usage or peak demand.
- (11) "Energy efficiency ("EE") program": a Commission approved program that is aimed at influencing and reducing natural gas or electricity usage or peak demand.
- (12) "Fixed Cost Recovery Shortfall": under-recovered fixed costs from reduced kWh or therm sales resulting from DSM/EE Programs due to the volumetric recovery of fixed utility costs based on historical sales and cost information. $F CRS = DSM/EE \text{ Savings (kWh/Therm)} \times \text{Fixed Cost Recovery Volumetric Rate}$.
- (13) "Fixed Cost Recovery Volumetric Rate": a study performed by the utility using the cost of service performed in the most recent rate case approved by the Arizona Corporation Commission. This rate shall be expressed in terms of a per kWh or per therm rate which represents utilities' non-customer-related costs but recovered on a volumetric basis.
- (14) "Measure": an individual component or technology in a DSM program.
- (15) "Net Benefits": the incremental lifetime benefits resulting from DSM minus the incremental costs of DSM. Benefits and costs are those defined by the TRC test.
- (16) "Persistence": savings from DSM measures installed during the years applicable to the Energy Efficiency Standard will be presumed to persist even after measure life and will be replaced with similar or better efficiencies due to market transformation efforts delivered by utilities, technology improvements and changes in codes and standards.
- (17) "Program Costs": the costs to research, plan, implement and administer DSM/EE programs.
- (18) "Recovery mechanism": a provision authorized by the Commission, which allows for increases and decreases in customer charges attributable to increases and decreases in specific costs incurred by a utility.
- (19) "Total Resource Cost (TRC) test": an economic test used to compare the present value of the benefits to the present value of the costs over the useful life of a DSM/EE measure or program, including the economic value of non-energy benefits.

R14-2-XXX3 Goals and Objectives

Beginning in 2010, all Class A utilities according to A.A.C. R14-2-103 (A)(3)(q) shall implement DSM programs and/or EE programs that achieve electric energy savings equivalent to at least five-tenths of one per cent (0.5%) of the Affected Utility's applicable annual percentage

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to the retail kWh sold during that calendar year for electric energy savings and one-tenth of one percent (0.10%) of natural gas savings as a percent of natural gas retail sales. Table 1 and Table 2 present the electric and natural gas energy efficiency resource standards for all affected electric and natural gas utilities.

Table 1: Electric Energy Efficiency Resource Standard

Years	Calendar Year	Annual Energy Savings as % of Sales	Cumulative Savings as % of Sales
1	2010	0.50%	0.50%
2	2011	0.60%	1.10%
3	2012	0.80%	1.90%
4	2013	1.0%	2.90%
5	2014	1.1%	4.00%
6	2015	1.1%	5.10%
7	2016	1.1%	6.20%
8	2017	1.1%	7.30%
9	2018	1.1%	8.40%
10	2019	1.1%	9.50%
11	2020	1.1%	10.60%
12	2021	1.1%	11.70%
13	2022	1.1%	12.80%
14	2023	1.1%	13.90%
15	2024	1.1%	15.00%

Table 2. Natural Gas Energy Efficiency Resource Standard

Years	Calendar Year	Annual Natural Gas Savings as % of Sales	Cumulative Savings as % of Sales
1	2010	0.10%	0.10%
2	2011	0.20%	0.30%
3	2012	0.30%	0.60%
4	2013	0.40%	1.00%
5	2014	0.50%	1.50%
6	2015	0.60%	2.10%
7	2016	0.60%	2.70%

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8	2017	0.60%	3.30%
9	2018	0.60%	3.90%
10	2019	0.60%	4.50%
11	2020	0.60%	5.10%
12	2021	0.60%	5.70%
13	2022	0.60%	6.30%
14	2023	0.60%	6.90%
15	2024	0.60%	7.50%

Utilities shall utilize the following EERS guidelines:

- (1) Cumulative savings as a percentage of sales will be calculated using the principle of persistence.
- (2) kWh reductions from Utility DSM/EE Programs in effect from January 2005 until the date this standard is approved will be credited toward meeting the goals of the EERS.
- (3) Demand Response programs may be credited toward compliance with this standard based on an assumed 50% annual load factor.
- (4) Energy savings from efficiency improvements to the utility delivery system, such as installing higher efficiency distribution transformers and more efficient conductors, shall be credited towards meeting the EERS.
- (5) If incremental energy savings in any year exceeds the applicable annual target established by these Rules, the additional energy savings may be carried forward and credited to a future year's annual target.
- (6) 'Cumulative Savings as a Percent of Sales' for the final year in the standard will be used to determine if a utility has successfully achieved the standard (i.e. 10% by 2020 or 15% by 2024).
- (7) Economic factors such as the costs and benefits associated with reliability shall be included in the TRC analysis. Electric utilities shall consider savings of natural gas; natural gas utilities shall consider savings of electricity.
- (8) Individual research and development and pilot programs do not have to demonstrate cost-effectiveness.

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R14-2-XXX4 DSM/EE Portfolio Plans and Programs

Utilities shall submit to the Commission a DSM/EE portfolio plan within (9) months of the adoption of these rules if an existing plan is not already filed and approved. New program plans and/or program updates shall be submitted to the Commission as required by the Commission.

(A) Each new DSM Portfolio plan, Program Plan or update shall include:

- (1) Programs for each customer class, including low income residential.
- (2) Specific funding levels and budgets.
- (3) Description of recovery mechanism that will be used to recover costs.
- (4) Demonstration that the funding proposed will be sufficient to deliver the program and advance the utility toward achievement of applicable EERS goals.
- (5) Demonstration that programs, excluding program offerings to low income residential customers, will collectively be cost-effective using the total resource cost test unless otherwise approved by the Commission.
- (6) A description of the process for measurement and verification of incremental energy savings from each EE program.
- (7) Allowance for the coordination of EE programs with the energy efficiency programs of other utilities.
- (8) New program proposals shall include:
 - a. Description of the program;
 - b. Objectives and rationale for the program;
 - c. Market segment at which the program is aimed;
 - d. Estimated level of program participation;
 - e. Estimate of baseline;
 - f. Estimated societal benefits and savings from the program;
 - h. Estimated societal costs of the programs;
 - i. Marketing and delivery strategy;
 - j. Utility costs and budget;
 - k. Calculation of the affect on the utilities recovery mechanism;
 - l. Demonstration that the utility's energy efficiency programs, excluding program offerings to low income residential customers or market transformation programs, will collectively be cost-

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- effective, using the total resource cost test unless otherwise approved by the Commission;
- m. Implementation schedule;
- n. Monitoring and evaluation plan; and
- o. Proposed performance incentives.

(B) The Commission may coordinate energy efficiency programs among consenting utilities where feasible and if such coordinated programs would help to maximize energy savings on a statewide basis. However, utility costs to comply with any coordinated effort shall only be used to fund programs and/or services in that utility's service territory. To prevent any potential double-counting on participation and claimed saving, Utilities working cooperatively on joint-delivery of DSM programs shall propose to the Commission a methodology for reporting and claiming savings.

R14-2-XXX5 Compliance Report

The Compliance Report shall include:

- (1) The estimated annual and lifetime electricity or natural gas savings achieved by the utility through energy efficiency programs provided during the reporting period, in actual quantities (MWh and therms), as an annual percent of retail sales, and as a percent of resources.
- (2) The estimated incremental peak reduction achieved by programs implemented during this reporting period.
- (3) Annual and program-to-date participation in each program
- (4) Expenditures made on energy efficiency programs during the reporting period and anticipated future expenditures to comply with the energy efficiency resource standard.
- (5) The cost-effectiveness of individual programs, and an overall cost-effectiveness of the DSM/EE Portfolio, based on the total resource cost test.
- (6) An overall estimate of lifetime economic net benefits.
- (7) An assessment and forecast of necessary program changes going forward.
- (8) An estimate of costs and savings for the following year.

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R14-2-XXX6 DSM/EE Cost Recovery

- (A) The Commission shall authorize utilities full cost recovery to research, plan, design, implement, and evaluate approved DSM/EE programs. Costs exceeding the overall funding levels specified in the DSM/EE program or portfolio filing may be recovered as long as those costs are deemed by the Commission to be prudent and reasonable.
- (B) Utilities, through measurement and evaluation activities, shall monitor DSM programs to ensure cost-effectiveness. Utilities shall propose modification or termination of programs that fail to meet expected results.
- (C) To effectively implement programs, cost recovery shall be concurrent (on an annual basis) with DSM spending.
- (D) DSM funds may be used for market studies, participation in consortium memberships and DSM industry events, labor costs for portfolio development, and other items for which the costs are difficult to allocate to individual DSM programs.
- (E) Utilities shall allocate costs in accordance with Generally Accepted Accounting Principles.
- (F) Recovery of DSM costs shall be applied to all retail customers regardless of the source of electricity or natural gas supply.

R14-2-XXX7 Net Benefits

The Commission shall authorize Electric and Gas Utilities to receive a net benefits incentive:

- (A) Net benefits incentive – utilities shall share in the net benefits received from DSM/EE programs. Providing customers with a XX% share and utilities with XX% share of the overall net benefits of the DSM/EE Portfolio implementation excluding Low-Income Weatherization programs, market transformation programs such as educational programs and Measurement, Evaluation and Research costs.
 - (1) The net benefits will be calculated each reporting period and will be included in the annual true up of the utilities' DSM adjustor mechanism
 - (2) The net benefits will be verified through the Measurement and Evaluation process via the saving determination.
 - (3) The total of each program's net benefits (or net costs) will be calculated and summed. This is an after tax performance incentive.
 - (4) The gross revenue conversion factor (as determined by the utilities last rate case filing) is applied to the total sum of the net benefits to arrive at a before tax performance incentive to be included in the adjustor mechanism.

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R14-2-XXX8 Fixed Cost Recovery Shortfall

The Commission shall authorize utilities to collect shortfalls in the recovery of fixed costs incurred in connection with EERS.

R14-2-XX9 Baseline Estimation

(A) The baseline for determining the incremental costs and benefits of a DSM/EE program shall be a reasonable estimate of the level of electric and/or natural gas demand and/or consumption and associated costs that would have occurred in the absence of the DSM/EE program.

(B) For demand response programs, customer load profile information may be used to verify baseline consumption patterns and the peak demand savings resulting from demand response actions.

(C) The cost of these studies should be collected through the utilities approved funding mechanism.

R14-2-XX10 Monitoring, Evaluation, and Research

(A) Utilities shall monitor and evaluate all DSM/EE programs to reliably ensure that they are cost-effective. Monitoring and evaluation should:

- 1) Determine participation rates, energy savings, and demand reductions;
- 2) Assess the utility's program implementation process;
- 3) Provide information on whether to continue, modify, or terminate a program; and
- 4) Determine the persistence and reliability of DSM/EE.

(B) Evaluation and research may also be conducted for program planning, product development, and program improvement. Evaluation and research includes market studies, baseline studies, market research, and other technical research for planning purposes.

R14-2-XX11 Leveraging and Cooperation

Utilities shall make reasonable use of cost sharing, leveraging, or other opportunities available from customers, vendors, manufacturers, government agencies, other utilities, and others that increase the effectiveness of the DSM/EE program and/or lower its costs.

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R14-2-XX12 Other Approaches to DSM/EE

In general, the Commission supports other approaches to DSM/EE, including building codes, appliance efficiency standards, shared savings legislation, and actions in other forums that would complement the advancement and implementation of cost-effective and prudent demand-side management initiatives.