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BEFORE THE ARIZONA CORPORATION COMMISSION
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IN THE MATTER OF THE PROPOSED
RULEMAKING ON ELECTRIC ENERGY
EFFICIENCY

Docket No. RE-00000C-09-0427

ARIZONA PUBLIC SERVICE
COMPANY'S RESPONSE TO
STAFF'S PROPOSED ENERGY
EFFICIENCY RULES

I. Introduction.

On October 29, 2009, the Arizona Corporation Commission ("Commission") Staff filed proposed electric energy efficiency rules ("October Draft Rules"), and encouraged all interested parties to provide written comments regarding their proposal. Arizona Public Service Company ("APS" or "Company") filed comments on the rule package on November 13, 2009, which detailed the Company's recommendations, and included specific proposals for energy efficiency rule language. On December 4, 2009, Staff filed another version of proposed rules ("Proposed EE Rules"), which includes some significant changes from the October Draft Rules. In this filing, APS has limited its comments to the key components of the Proposed EE Rules; however, the Company continues to support the proposals included in its November filing.

APS is a strong proponent of energy efficiency and is the leading provider of Demand Side Management ("DSM") programs in Arizona. APS recognizes the value of energy efficiency, as these programs provide customers a means to lower their energy bills, provide for reductions in fuel costs and environmental impacts, and have the potential to defer certain investments in generation and transmission infrastructure over the long-term. APS has

1 actively participated in the Commission energy efficiency workshops to develop a state-wide
2 energy efficiency standard and supports the development of such a standard. Importantly, in
3 addition to establishing energy savings targets, the development of a state-wide energy
4 efficiency standard also allows for the adoption of other policies or provisions that are
5 necessary for affected utilities to achieve the energy savings reflected in the standard. In
6 particular, these include providing for adequate and timely funding to achieve the standard,
7 and addressing the regulatory disincentives associated with implementing an energy
8 efficiency standard.

9 APS's most serious concern with the Proposed EE Rules is the absence of any
10 discussion regarding the issue of regulatory disincentives. The energy efficiency standard
11 proposed by Commission Staff ("Proposed EE Standard") is one of the most aggressive
12 standards in the nation, and yet the Proposed EE Rules are silent regarding the need to
13 address the significant problem of utility disincentives to promote programs that impact the
14 ability of the utility to recover prudently-incurred costs. The contrast of these two aspects of
15 the Proposed EE Rules is stark and troubling. If the Commission does not address the
16 ratemaking disincentives associated with uncollected fixed costs in a generic docket or in
17 each affected utility's next rate case, the aggressive levels of energy efficiency savings in the
18 Proposed EE Rules are not sustainable.

19 **II. Cost Recovery: The Critical Need to Align Customer and Utility Interests.**

20 As Chairman Mayes acknowledged in her November 30th letter, to ensure that energy
21 efficiency approaches can be sustained in the long-term, it is critical that the Commission
22 address the rate and regulatory disincentives that will result from the implementation of the
23 Proposed EE Standard. These disincentives are primarily related to the fixed costs of
24 providing service to customers, which under traditional ratemaking practices are mostly
25 recovered through volumetric rates, such as a usage charge.¹ Under existing ratemaking
26 practices, when kilowatt-hour sales decrease in response to energy efficiency programs

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28 ¹ These costs do not fluctuate with the amount of energy consumed. Examples of fixed costs include those costs associated with the existing generation fleet and transmission and distribution wires, among others.

1 between rate cases, fixed costs will never be fully recovered. This under-recovery results in
2 significant financial harm to the utility. Therefore, to promote sustained energy conservation,
3 ratemaking approaches must be modified to ensure that utilities have a reasonable opportunity
4 to recover the fixed costs of serving their customers. This critical issue is not solely a
5 concern of utilities – energy efficiency and environmental advocates have been urging the
6 adoption of policies, such as utility revenue decoupling, because they recognize the need to
7 act on this issue if energy efficiency policies are going to be sustainable and effective.²
8 Further, other regulatory jurisdictions implementing ambitious energy efficiency programs
9 have also adopted effective regulatory practices that remove the disincentive for utilities to
10 encourage energy efficiency and align customer and shareholder interests to provide for more
11 economically and environmentally efficient decisions.³

12 Addressing regulatory disincentives is an issue wholly distinct from the topic of
13 performance incentives. The performance incentives that are included in the Proposed EE
14 Rules are intended to encourage utility implementation of energy efficiency programs to
15 maximize the customer benefits of such programs, while the regulatory disincentive is
16 essentially a ratemaking issue. Of particular importance is the fact that the magnitude of
17 regulatory disincentives is significantly greater than any revenues that would be associated
18 with performance incentives.

19 APS recognizes that the accelerated timeframe to promulgate these Proposed EE Rules
20 precluded a full examination of the ratemaking approaches that could be modified to assure
21 that utilities have the opportunity to recover the full fixed costs of serving their customers.
22 Nonetheless, regulatory actions, such as the development of rate design and ratemaking
23 methods that resolve regulatory disincentives/barriers for public utilities to achieve increased
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25 ² See *Energy Washington Week*, Vol.6, No. 43, Oct. 28, 2009.

26 ³ The California Public Utility Commission, the New York Public Service Commission, the Massachusetts
27 Department of Public Utilities, the Vermont Public Service Board, and the Maine Public Utility Commission
28 have all adopted ratemaking approaches to address these issues. APS's November 13, 2009 filing in this
docket includes a more detailed discussion of these approaches at pages 3-7. In addition, federal law has also
expressly recognized the disincentive to utility promotion of energy efficiency programs. See Energy
Independence and Security Act of 2007, Section 532(a)(16) and (17).

1 energy efficiency savings, are fundamental to sustainable energy efficiency programs. For
2 that reason, in these rules APS is simply seeking the inclusion of language that acknowledges
3 that the Commission would address regulatory disincentives either in a generic docket, or no
4 later than each utility's next rate case filed following the approval of the rules. If the issue of
5 regulatory disincentives is not addressed, the Proposed EE Standard is simply not sustainable
6 and the long-term objectives for this standard cannot be achieved.⁴

7 **III. Energy Efficiency Standard.**

8 The Proposed EE Rules set forth a rigorous Proposed EE Standard – one of the most
9 ambitious standards in the country. While APS is a strong supporter of energy efficiency, the
10 Company believes there are several aspects of the Proposed EE Standard that the
11 Commission should modify.

12 Instead of a cumulative 2020 energy efficiency standard as was discussed during the
13 workshops, in the Proposed EE Rules Staff has proposed annual requirements. Unlike the
14 Renewable Energy Standard (“RES”) Rules, the Proposed EE Rules do not allow an affected
15 utility that exceeds the compliance target in any year to apply the over-compliance to a future
16 year's compliance. Without such ability to “bank” energy savings, a utility will have no
17 incentive to strive for energy efficiency savings beyond that required by the rules. To address
18 this issue, APS recommends that the Commission include the following language, which is
19 similar to the RES Rule approach,⁵ in Proposed EE Rule R14-2-2404(A):

20 An Affected Utility may use Energy Savings acquired in any year to meet the
21 Energy Efficiency Standard requirements.

22 In addition, the Proposed EE Standard fails to allow for a ramp-up period to develop
23 programs, educate customers, and implement the programs. Instead, it has an initial
24 requirement for a two percent reduction in retail sales in 2011, an amount that is significantly
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26 ⁴ Another benefit of including such language is that it would reinforce the position that promulgation of energy
27 efficiency rules is directly related to the Commission's constitutional ratemaking authority, making them less
susceptible to potential legal challenge.

28 ⁵ RES Rule R14-2-1804(C) states: “An Affected Utility may use Renewable Energy Credits acquired in any
year to meet its Annual Renewable Energy Requirement.”

1 higher than the level of savings currently being achieved, even with APS's robust DSM
2 programs. It is unlikely that DSM programs will be able to ramp up in sufficient time to meet
3 the Proposed EE Standard in the early years, particularly with the impact of the current
4 economic recession on customers' ability and willingness to invest in energy efficiency
5 measures.

6 Furthermore, the Proposed EE Rules have eliminated valid, tangible categories of
7 energy savings that should be counted toward the aggressive standard. APS is concerned by
8 the inconsistency of such an aggressive Proposed EE Standard and the lack of recognition of
9 legitimate sources of energy savings that should be counted in assessing compliance with that
10 standard.

11 For example, the Proposed EE Rules, in contrast to the October Draft Rules, preclude
12 the utilities from counting historical energy savings from DSM programs or measures that
13 were implemented prior to the effective date of the Proposed EE Rules. This is unfair for
14 utilities that have been developing and implementing effective DSM programs, such as APS.
15 Instead of allowing the Company to receive full credit for its efforts, this approach effectively
16 penalizes APS for aggressively pursuing energy efficiency savings earlier than other utilities.
17 In addition, this approach provides a disincentive for all utilities to achieve additional savings
18 prior to the effective date of the Proposed EE Rules. For these reasons, APS urges the
19 Commission to allow historic energy savings from DSM programs to count towards the
20 achievement of the Proposed EE Standard.

21 Likewise, the Proposed EE Rules specifically preclude an affected utility from
22 counting demand response and load management programs toward meeting the standard.
23 Here again the Proposed EE Rules have taken a 180 degree turn from what Staff had
24 proposed in the October Draft Rules, which allowed the results of these programs to count up
25 to two percentage points of the energy standard.⁶ Demand response programs can provide an
26 effective way of meeting future summer peak capacity requirements, and may provide a more
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28 ⁶ See October Draft Rule R14-2-2404(C).

1 cost-effective way of meeting the requirements of the Proposed EE Standard. The inability to
2 count savings from demand response and load management programs makes achieving the
3 standard both less likely and more expensive. Because of the considerable efforts to develop
4 and implement these programs, the utilities may rationally focus primarily on other programs
5 that allow them to comply with the aggressive Proposed EE Standard.

6 Finally, the Proposed EE Rules do not include any provision for acknowledging the
7 impact of increasing building codes and appliance efficiency standards on the Proposed EE
8 Standard. As building codes and appliance efficiency standards are changed and raised over
9 time, they raise the baseline against which utility program efficiency improvements are
10 measured. As such, increases in building codes and standards make it more difficult and
11 expensive to attain yet additional energy savings from utility energy efficiency programs.
12 Because a utility can only claim the incremental energy savings between standard equipment
13 and high efficiency equipment, when the standard equipment improves, there is less energy
14 savings available to meet the Proposed EE Standard.

15 Estimating the near term impact of enhanced codes and standards is inherently
16 difficult; however, the significant role of building codes and standards in achieving the
17 Proposed EE Standard cannot be ignored. Therefore, the Proposed EE Rules should permit
18 utilities to allocate funding to advocate for increases in building codes and appliance
19 standards that are designed to reduce energy usage. Subsequently, affected utilities should be
20 able to count one-half of the energy savings resulting from those improvements in building
21 codes and standards. This approach is currently being addressed in other states.

22 Addressing each of these issues – banking energy savings, a reasonable ramp up in the
23 standard, and the inclusion of energy savings from things like demand response and
24 improvements in building codes and appliance standards – will improve the Proposed EE
25 Standard and help ensure that it can be met in a cost-effective manner. Ignoring these issues
26 appears to fly in the face of what APS perceived to be the intent of the Proposed EE Rules: to
27 make Arizona a national leader in all aspects of energy efficiency.

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1 **IV. Performance Incentive.**

2 APS agrees with the tiered performance incentive approach that is included in the
3 Proposed EE Rules, because it encourages performance over and above the annual efficiency
4 savings goals by offering increased incentives as the goals are met and exceeded. This
5 incentive structure will require utilities to focus on programs with the highest net benefits to
6 customers, in order to maximize potential incentives.

7 APS notes that the Proposed EE Rules allow for a performance incentive for “an
8 affected utility that achieves at least 85% compliance with the annual energy efficiency
9 standard in a calendar year” (R14-2-2411(A)), which is consistent with the Staff’s October
10 Draft Rules. However, it appears that the first line of the table, which is included in the
11 Proposed EE Rules, was inadvertently omitted. APS believes that there is no need to include
12 the table in the Proposed EE Rules because the appropriate level of performance incentive
13 may change over time. By omitting the table, the Commission would have more flexibility to
14 determine the appropriate incentive for an affected utility.

15 Different from the approach set forth in the Proposed EE Rules, APS believes that the
16 performance incentive should be collected in the same calendar year in which the affected
17 utility incurs the program costs and produces the net benefits to customers upon which the
18 performance incentive is based. The performance incentives should be based on estimated
19 costs and then later trued-up to actual costs and incentives earned. The Commission has
20 approved this approach in Decision No. 70628,⁷ and a similar approach has been proposed by
21 the settling parties in APS’s current rate case settlement agreement, which is pending
22 Commission approval.⁸

23 **V. Implementation Plans and Reporting Requirements**

24 APS is generally supportive of the provision in the Proposed EE Rules regarding the
25 implementation plans and reporting requirements; however, the Company does have concerns
26 about two elements. The Company does not object to the concept of bi-annual

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28 ⁷ This Commission Decision addresses Tucson Electric Power Company’s DSM adjustor.

⁸ Docket No. E-01345A-08-0172.

1 implementation plan filings, but believes that to smooth rate impacts associated with DSM
2 spending, that a DSM tariff filing complying with Proposed EE Rule R14-2-2406(A), or a
3 request to modify and reset an adjustment mechanism complying with Proposed EE Rule
4 R14-2-2406(C) should be filed on an annual basis.

5 The Company also has concerns about the provisions to include “pie charts” on
6 customer bills that show the total amounts billed and a breakdown of all surcharges. At
7 present, the APS billing system does not have the capability to create such a chart, and it
8 would require extensive and costly upgrades in order to provide this information on a per
9 customer basis. APS proposed two alternative approaches for providing information to
10 customers: posting information to APS’s customer account web pages; or to provide
11 information once a year (based on average class usage, such as residential or commercial).
12 These alternatives were discussed in APS’s November filing.⁹

13 **VI. Conclusion.**

14 APS supports the development of state-wide energy efficiency rules for all
15 jurisdictional utilities. To ensure the sustainability of the Proposed EE Rules, especially the
16 aggressive levels of energy efficiency required to meet the Proposed EE Standard, the rules
17 must not only include provisions for adequate and timely funding to achieve the Proposed EE
18 Standard. The Proposed EE Rules must also recognize the need to address regulatory
19 disincentives – whether in a generic docket or in affected utilities’ subsequent rate case
20 filings. Additionally, APS believes that to make Arizona a national leader in energy
21 efficiency and to better ensure that the Proposed EE Standard is achievable, the Proposed EE
22 Rules should allow for the banking of energy savings, a reasonable ramp up in the standard,
23 and allow other legitimate categories of energy savings, such as demand response and
24 building codes and appliance standards.

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28 ⁹ See pgs. 15-16.

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RESPECTFULLY SUBMITTED this 11th day of December, 2009.

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