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COMMISSIONERS

KRISTIN K. MAYES - CHAIRMAN
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

	)	DOCKET NO. E-00000J-08-0314
	)	DOCKET NO. G-00000C-08-0314
IN THE MATTER OF THE GENERIC	)	TUCSON ELECTRIC POWER
INVESTIGATION OF REGULATORY AND	)	COMPANY, UNS ELECTRIC, INC.
RATE INCENTIVES FOR GAS AND ELECTRIC	)	AND UNS GAS, INC. COMMENTS
UTILITIES	)	TO DRAFT POLICY STATEMENT
	)	REGARDING UTILITY
	)	DISINCENTIVE TO ENERGY
	)	EFFICIENCY AND DECOUPLED
	)	RATE STRUCTURES

Tucson Electric Power Company ("TEP"), UNS Electric, Inc. ("UNS Electric"), and UNS Gas, Inc. ("UNS Gas"), collectively referred to as "the Companies", hereby jointly file their comments to the Arizona Corporation Commission's ("Commission") Draft Policy Statement Regarding Utility Disincentives and Decoupled Rate Structures (Docket Nos. G-00000C-08-0314 and E-00000J-08-0314 (October 18, 2010)).

INTRODUCTION.

During the Energy Efficiency ("EE") rulemaking proceedings, the Companies stressed the importance of putting in place a mechanism that would allow utilities to recoup lost revenues caused by reduced energy usage and, consequently, sales. Although not included in the EE rules, there was a general consensus that such a mechanism is necessary in order for utilities to meet EE standards and retain a meaningful opportunity to realize their last authorized rate relief. This sentiment was further bolstered by the findings of the Lawrence Berkeley National Laboratory study and report that was prepared at the Commission's request.

1 The Companies recognize that the Draft Policy Statement represents another significant
2 step by the Commission to ultimately implement revenue recovery mechanisms. However, it
3 should not be viewed as the last step, or as one that can slow down the implementation date for
4 such a mechanism. Rather, by being offered for comment and Commission approval now, the
5 Draft Policy Statement should provide a clear framework for the action that should be taken prior
6 to the effective date of the EE rules. The Companies' comments reflect the need for a revenue
7 recovery mechanism to be in place at the same time that the EE rules become effective.
8

9 The Companies agree with the theme of the Draft Statement that (i) the confluence of
10 traditional ratemaking, EE rules, demand side management ("DSM") rules and distributed
11 generation ("DG") requirements create inequities and obstacles that should be addressed; and (ii)
12 revenue recovery mechanisms, such as decoupling, are the solution to the problem.
13

14 The Companies' rates have been set by the Commission with the premise that prudently
15 incurred costs and a reasonable return on investment will be recovered through fixed and
16 volumetric charges. However, that premise is eroded by EE, DSM and DG requirements designed
17 to reduce volumetric sales. The Companies recognize the benefits to their customers of the EE,
18 DSM and DG requirements and desire that associated programs be implemented in ways that are
19 beneficial to customers but not detrimental to the financial health of the utilities. The timely
20 implementation of revenue recovery mechanisms such as decoupling meet the needs of the
21 customers and the utilities. Accordingly, the Companies' comments request that the
22 implementation date of a revenue recovery mechanism such as decoupling be synchronized with
23 the effective date of the EE rules. If time does not allow for that to occur, then the Companies
24 propose that a lost revenue adjustor be immediately implemented and operate until such time as
25 decoupled rates are put in place.
26
27

1 The Companies have attached a red-lined version of the Draft Policy Statement (Exhibit A)
2 as well as answers to the three questions posed by Chairman Mayes in her correspondence dated
3 October 18, 2010 (Exhibit B).

4 The Companies reserve their right to supplement these Comments in response information
5 provided by other interested parties or in the event that additional issues are raised.

6 RESPECTFULLY SUBMITTED this 28th day of October 2010.

7
8 TUCSON ELECTRIC POWER COMPANY, UNS ELECTRIC,
9 INC. AND UNS GAS, INC.

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24 Original and 15 copies of the foregoing
25 filed this 28th day of October 2010 with:

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27 Arizona Corporation Commission
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EXHIBIT

"A"

**ACC Policy Statement Regarding Utility Disincentives to Energy Efficiency
and Decoupled Rate Structures**

POLICY STATEMENTS

1. Diversity and utilization of both demand and supply side options for meeting Arizona's energy resource needs is beneficial and should be actively pursued by Arizona utilities as a way of moderating capital expenses, encouraging greater flexibility, and ensuring reliability. ~~and minimizing rate impacts and customer energy bills.~~

Comment:

While minimizing rate impacts is one of the targets, the Companies are not certain that diversity and utilization of both demand and supply side options will minimize rate impact.

2. Arizona utilities should pursue all cost-effective energy efficiency and demand side management resources, to ~~and should~~ meet Arizona's Electric and Gas Energy Efficiency Standards of at least 22% electric energy savings and at least 6% gas savings by 2020.

Comment:

The Companies believe that the Policy Statement should encourage utilities to meet the requirements of the Energy Efficiency Standards in their current and future versions.

3. Revenue decoupling may offer significant advantages over alternative mechanisms for addressing utility financial disincentives to energy efficiency, as it establishes better certainty of utility recovery of authorized fixed costs and better aligns utility and customer interests. ~~However, if properly designed, alternative mechanisms could be implemented that would provide significant incentives to utilities to go beyond complying with the Commission's Energy Efficiency Rules just because they are required to do so, but to actually promote energy efficiency.~~ Some form of decoupling and ~~or~~ utility financial incentives must be adopted in order to encourage aggressive use of demand side management programs and the achievement of Arizona's Electric and Gas Energy Efficiency Standards, which will benefit ratepayers and minimize utility costs. These types of mechanisms offer short term and long term benefits: in the short term ~~it~~ they allow for customers bill savings through increased energy efficiency, achieved through Commission-approved energy efficiency programs; in the long term they contribute to plant deferrals and may contribute to improvements in costs of capital.

Comment:

Revenue decoupling and other alternative recovery mechanisms are designed to make the utility whole from the change in rate making paradigm as well as to encourage energy efficiency efforts. The Companies proposed language better reflects these purposes.

4. While other decoupling models are appropriate in general, revenue per customer decoupling may be well suited for Arizona as it responds to customer growth and is better suited to address the issues associated with customer growth. Utilities interest in revenue per customer decoupling must address whether new customers should be treated distinctly from existing customers.

5. Adoption of decoupling (or any other alternative mechanism that provides utility lost revenue recovery associated with incentives to promote energy efficiency) should not occur as a pilot, as this insufficiently supports demand side management efforts, discourages beneficial changes to rate design and is unlikely to encourage financial ratings improvements. In lieu of pilot adoption, an initial three-year review period should be utilized which allows for evaluation and redress of decoupling models and related issues. The initial review period should be three years or until the company files its next rate case after a decoupling or alternative mechanism is approved. The formal review of the mechanism should begin 20 months after it is approved, to allow adequate time for review by the Commission prior to the beginning of the subsequent period. If Commission Staff is not able to conduct this review due to resource constraints, an evaluation contractor shall be hired by the utility. For those utilities with rate freeze obligations, the effective date for compliance with the Energy Efficiency Rules will be synchronized with implementation of a lost revenue recovery. The utility may request a lost revenue adjustor mechanism be implemented as a bridge until such time as the utility receives an order for decoupled rates.

Comment:

The Companies believe the above language needs to be added for those utilities, like TEP, that have negotiated rate settlements with frozen rates based on certain assumptions. The implementation of the Energy Efficiency Rules changes the assumption made in settlements like TEP's. Moreover, it deprives TEP of its opportunity to recover costs and earn a reasonable return on its investments. The issues can be fixed, however, with the addition of a lost revenue adjustor mechanism for use between the implementation of the Energy Efficiency Rules and the Company's next general rate case. Additionally, the Companies believe that it is imperative for any approved decoupling mechanism to be implemented coincident with the Energy Efficiency Rules.

6. Commitment to and early implementation of decoupling should precede significant adjustments to cost of capital if a revenue per customer decoupling mechanism is approved for a utility. Therefore, decoupling-specific adjustments to cost of capital should not be proposed for the initial review period. The review of the initial three-year period following adoption of revenue per customer decoupling should include analysis and discussion of possible adjustments to cost of capital to recognize any modified risk at the utilities, as well as benchmarking and comparisons to other utilities operating with revenue per customer decoupling. Moreover, implementation of decoupling and the lost revenue recovery mechanism should occur coincident to the implementation of the Energy Efficiency Rules.

Comment:

Again, the Companies believe that timing the implementation of a decoupling mechanism with the effective date of the Energy Efficiency Rules is imperative to increasing energy efficiency in Arizona and to overcoming the potential loss of revenues.

7. Utilities are encouraged to develop customer rate designs that support energy efficiency and work well in tandem with decoupling (or alternative mechanisms). Utilities may propose preliminary rate designs for the initial three-year period, and the preliminary rate designs should be evaluated during the review of the initial period. Revisions to the preliminary rate designs based on the results of the review should be proposed for the subsequent period.

8. Full decoupling is preferable to partial decoupling as it contributes to greater rate stability which may allow for ~~would encourage~~ improvements in financial ratings, is administratively more manageable, and offers opportunities for rate relief following extreme weather events.

Comments:

While improving financial ratings is the goal, the Companies are not certain that full decoupling will encourage these improvements.

9. Weather normalization in the application of decoupling is discouraged because such normalization would reduce the size of decoupling surcredits to customers following an extreme weather event.

10. Decoupling adjustments should occur more frequently than on an annual basis, as this may provide ratepayers with weather related rate relief following extreme events. Current adjustments, on a monthly or even quarterly basis, where technologically and administratively feasible, allow for weather related rate relief and are encouraged.

11. Broad participation in decoupling is preferred; however, the unique characteristics of each utility may merit different treatment of some customer classes. Utilities should address any proposed distinct treatments and justify why certain customer classes may merit different treatment.

12. Decoupling adjustments should be blended and applied across customer classes to discourage dramatic changes experienced by any one class.

13. Decoupling adjustments applied in a manner to encourage energy efficiency are preferred, such as applying decoupling surcharges to rates and higher-usage blocks to encourage energy efficiency, and applying decoupling surcredits to reward customers who use less energy.

14. Collars or caps on decoupling adjustments should be designed to encourage gradualism, and to minimize the short-term effects on customers. If the decoupling adjustments are to occur on a monthly, quarterly, or less-than-annual basis, the utility should propose a cap for the periodic decoupling adjustments. Any unrecovered balances will be carried forward until the next adjustment period. Customers should receive the full amount of any credit refund in a timely manner in the event that achieved revenue per customer exceeds authorized revenue per customer. Therefore, it is not necessary to cap the amount of surcredit decoupling adjustments or credits refunds to customers.

Comments:

The Companies believe that customers should receive the full amount of any credit as opposed to a refund. Credits allow the utility to make adjustments such as these on a customer's bill rather than issuing checks to customers.

ORDER

A utility may file a proposal for alternative mechanisms to recover revenue shortfalls attributable for addressing utility financial disincentives to energy efficiency, demand side

management and distributed generation, including revenue per customer decoupling, in its next general rate case. A utility filing such a decoupling proposal should address this policy in its filing and should use this policy as a guideline in development of its proposal. Moreover, it is the intent of the Commission that the decoupling mechanism be in place coincident to the implementation of the Electric and Gas Energy Efficiency Rules. Any lapse between implementation of the Energy Efficiency Rules and a utility's next general rate case should be addressed through the use of an alternative recovery mechanism, including a lost revenue adjustor.

EXHIBIT

"B"

Tucson Electric Power Company's Responses to Chairman Mayes's Questions Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures

As requested by Chairman Mayes in her correspondence dated October 18, 2010, Tucson Electric Power Company ("TEP") provides the following responses to Chairman Mayes's questions.

1. The Lawrence Berkeley National Laboratories' ("LBNL") analysis of the benefits associated with the commission's Energy Efficiency Standard, as presented and discussed in the workshops, identified \$5.2 billion of ratepayer bill savings at Tucson Electric Power ("TEP") and Arizona Public Service Company ("APS") combined, even accounting for the rate impacts associated with decoupling. Please confirm for the Commission the basis of these savings, i.e. I would like both TEP and APS to identify which generation plants, both baseload and peaking, will be deferred as a result of the energy efficiency standard and for how long those plants will be deferred.

Answer:

In May 2010, TEP provided LBNL with a forecast of annual demand reductions associated with future energy efficiency programs. This forecast assumed a 20% energy efficiency target by 2020. Table 1, which was prepared by LBNL, reflects the amount of deferred generating capacity by year. This deferred capacity can be characterized as a mix of both intermediate and peaking capacity either from future market-based or self-built resources over the next ten years.

Table 1. LBNL Forecasted Demand Savings by Year

Year	Megawatts
2011	33
2012	70
2013	106
2014	142
2015	174
2016	209
2017	242
2018	274
2019	306
2020	337

2. If any utility that advocated for decoupling now believes that any of the deferrals identified in the LBNL analysis will not occur, please state so and any reasons for this change in assessment.

Answer:

TEP has no reason to believe that the deferrals identified in the LBNL analysis are not a reasonable estimate at this time. However, if material changes occur in the assumptions utilized by LBNL, the estimates may be subject to revision.

Tucson Electric Power Company's Responses to Chairman Mayes's Questions Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures

3. Please tell the Commission what your 2011 Integrated Resource Plans, to be filed soon with the Commission pursuant to the ACC's IRP rules, will state with regard to the Energy Efficiency Standard's impact on generation deferrals at your utility.

Answer:

At this time, TEP anticipates that its Integrated Resource Plan ("IRP") will reflect the generation deferrals depicted in Table 2. These figures are based on the Commission approved Energy Efficiency Rules and the targets contained therein. TEP's deferred capacity is expected to be a mix of intermediate and peaking capacity either from future market-based or self-built resources over the next ten years.

Table 2. TEP's IRP Forecasted Demand Savings by Year

Year	Megawatts
2011	59
2012	111
2013	157
2014	202
2015	242
2016	287
2017	332
2018	377
2019	421
2020	464