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Tucson Electric Power Company
One South Church Ave., P. O. Box 711
Tucson, Arizona 85702

Commissioner Paul Newman
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007-2996

Re: **2011 REST Implementation Plans; Request for additional information in advance of November workshop; Docket Nos. E-01933A-10-0266.**

Dear Commissioner Newman:

Thank you for your recent correspondence regarding Tucson Electric Power Company's ("TEP") and UNS Electric, Inc.'s ("UNS Electric") (collectively "Companies") 2011 Renewable Energy Standard and Tariff ("REST") Implementation Plans. In response to your request for additional information, the Companies respond as follows:

Transparency Issues; Possible Penalties for Non-Compliance

At the November 10, 2010 REST Open Meeting, the parties discussed at great length the issues of transparency and "phantom" projects. During the meeting it was noted that these issues arise primarily with large-scale utility projects. Moreover, with respect to the perceived disproportion between the number of "reserved" projects as opposed to the number of "completed" smaller scale distributed generation ("DG") projects, it was noted that a normal development period for these projects is between 12 and 18 months and most parties understand that reservations made in a given year will not be built in that year.

Regarding the issue of phantom utility-scale projects, neither TEP nor UNS Electric, Inc. have experienced the fallout that many other utilities have. This is due primarily to the fact both Companies favor a community approach to renewable generation, utilizing smaller-scale projects of 35 megawatts ("MW") and less. The Companies also have diversified their portfolios with 12 separate projects, thereby limiting the effect of any particular project's potential failure on the Companies ability to build utility-scale projects. While the Companies do expect some project fall out, more often than not these failures are due to the inability of a counterparty to secure financing. This inability to secure financing can occur with financing relatively new technologies, especially during an economic recession. To fully adjust for potential project fall out, the Companies project a 25% attrition rate into the utility-scale project selection process. This ensures that compliance with the RES is not jeopardized by phantom or fall out projects.

As the industry matures and more projects are being awarded, both TEP and UNS Electric intend to implement a deposit requirement following short-list notification during the request for proposal ("RFP") process. For large-scale production-based incentive ("PBI") projects (greater than 1 MW), the Companies favor requiring a deposit at the application stage.

Finally, the Companies have received no liquidated or other damages related to the fall out of projects, and have no employees or employees' relatives with financial involvement in any of the projects. If either Company were to receive some form of damages related to non-compliance, those funds would be credited to the respective Company's REST budget to offset existing subsidies. Additionally, these funds would be reflected in the Company's annual compliance filings and implementation plans.

Incentive Step-Downs Based on Capacity versus Number of Applications

Incentive step-downs were discussed at great length during the November 10 REST Open Meeting. The Companies were pleased that the stakeholders in attendance overwhelmingly supported TEP's and UNS Electric's step-down method (as proposed in the 2011 REST Implementation Plans).

In its REST Plan, TEP proposed that residential incentives be lowered from $2.00 per watt to $1.75 per watt if reservation totals exceed 60% of the projected annual revenues. Once this level is reached, TEP would set a date (approximately 30 days later) that the lower incentive would take effect. The 30-day delay is intended to provide a necessary bridge between the change in prices to allow TEP to make customers and installers aware of the change prior to its becoming effective. TEP believes this is the most effective step-down trigger mechanism. UNS Electric has a trigger that simply reduces the rate from $1.75 per watt to $1.50 per watt if 65% of funds have been reserved by June 30, 2011.

Increasing the RES to 20% by 2020

In order to address this question, TEP assumed a 2% increase in its renewable percentages beginning in 2012, increasing at 2% increments through 2019, with a 1% increase in 2020 to achieve a 20% target. Under these assumptions, as indicated in the table below, TEP estimates that increasing the RES to 20% by 2020 would increase RES budgets by $235,000,000 through 2015. TEP lacks any empirical data for budgets beyond 2015 and was unable to compare budget numbers beyond 2015.

	2011	2012	2013	2014	2015	Total
REST Budget for 15% target	$36,836,245	$52,802,605	$44,890,035	$42,649,216	$44,298,840	$221,476,941
REST Budget for 20% target	$78,047,966	$102,988,125	$93,647,487	$90,873,625	$90,799,327	$456,356,531
Budget Increase	$41,211,722	$50,185,521	$48,757,452	$48,224,409	$46,500,487	$234,879,589

A more rigorous look at these impacts could be addressed in the Integrated Resource Plans.

Cost of Imported Fuel versus In-State Generated Solar

TEP does not track its fuel sales by resource; all generation resources simply feed the grid from all locations. While the National Electric Reliability Council ("NERC") tagging process requires identification from source to sink for all energy transactions, it is not accurate to say the energy from one power plant flowed out of state while energy from another plant was consumed in-state. The tagging process was designed to assist reliability operators during transmission overloading conditions as a result of unscheduled flow. If every utility was prohibited from

selling energy and was required to only meet their needs using their resources, they would supply their system based on the lowest cost resource available. Using this scenario, most available sales would be from the highest cost resource at the time of the sale. In general for TEP, that would be coal during off-peak or nighttime hours and natural gas plants during on-peak or daytime hours (and would consist of peaking turbines, simple-cycle steam facilities, and combined-cycle facilities).

Regarding sales, both in and out of state sales are typically made based on incremental generating cost as compared to market cost (noting the few exceptions when sales must be made to generating plants at minimum levels for reliability must run purposes). There is no comparable market for renewable energy, and as such, no comparison to be made for exporting renewable energy.

Determining whether or not Arizonans would be advantaged by having merchant facility developers build facilities and export energy depends on several factors including: (i) which technology is used; (ii) whether that technology is using Arizona's water resources; (iii) where the components are being made (in or outside of Arizona); and (iv) which entity owns the facility. Most developers are not incorporated in the State of Arizona, nor do they procure their system components from Arizona manufacturers. This means that very little of the revenue generated from a merchant facility will remain in the Sate.

Relating the ratepayers costs associated with the various fuels used within the state not only highlights the already high cost of renewable energy to our ratepayers, but fails to take into account the additional costs that will be associated with removing baseload facility production and replacing that production with intermittent resources. As Commissioner Newman notes in his letter, the average person spent $77 to import coal, representing 25% of their electricity. Over the last few years, the cost of natural gas generation has been approximately twice that of coal generating facilities. Thus, it is reasonable to assume that an average person would spend about $150 for an equivalent 25% of gas. Alternatively, the average person will spend $40-50 this year on the REST, which represents only 3% of their electricity. Extrapolating that value out shows that equivalent REST expenditures for 25% of a ratepayer's electricity would be approximately $333-$416.

Given that natural gas fired facilities represent TEP's most-efficient, lowest carbon emitting baseload facilities, with the ability to be controlled and respond to system commands, it is difficult at this time to say solar provides the same value as natural gas.

Are 40% of the monies spent on solar offset by fuel savings?

For wholesale utility solar purchase power agreement ("PPA") purchases, the solar Market Cost of Comparable Conventional Generation ("MCCCG") approximates the value of the avoided or offset fuel costs. TEP's current solar PPA prices and MCCCG show that avoided fuel cost can be near or even more than 40% of the total PPA energy cost given the large tax incentives currently available to renewable resources. Absent these incentives, the amount of solar monies spent offset by fuel savings would likely be less than 40%. Lower projected future solar prices and higher projected conventional fuel costs would lead to fuel savings being higher than 40%.

Third Party Administration of RES Programs

The Companies believe that Kubert's and Sinclair's claim that utility administration of renewable energy ("RE") programs is more challenging than Third Party Administration ("TPA") models is inaccurate. To begin, the RES does not need to compete with the Energy Efficiency ("EE") Standard; the two standards are entirely different and focus on different resources. Moreover, rate proceedings are not "entangled" for REST discussions due to energy efficiency "least cost modeling." Instead, these two very different Standards are met through the Integrated Resource Planning process – which is more than just a "least cost modeling" exercise. Entanglement is much more likely to occur if a TPA has involvement in either EE or RE programs rather than the IRP methodology.

TEP and UNS Electric have demonstrated that they are successful renewable program administrators. Kubert's and Sinclair's claim that a TPA would know a utility's market better than the utility that has been a part of the community for 100 years lacks a factual basis. A TPA could not match the Companies' renewable energy implementation and integration expertise and deep knowledge of its community. Moreover, unlike a TPA, the utilities' renewable plans and associated budgets are fully vetted by the Commission and its Staff. This adds a layer of transparency and accountability that may not be found with TPAs. Utilities also have a firsthand knowledge of the technology, integration, and network requirements of integrating renewable energy. This knowledge cannot be matched outside the utility.

Lastly, TEP has been in relationship with its customers for decades; the trust between utility and customer cultivated over time cannot be duplicated by a TPA operating outside of the community. As demonstrated by TEP's excellent renewable energy initiatives and recognized leadership, it is clear that in Arizona, the utility is the best administrator of renewable energy programs.

Sincerely,

Philip J. Dion
Vice President, Public Policy

cc: Commissioner Gary Pierce
Commissioner Sandra Kennedy
Commissioner Paul Newman
Commissioner Bob Stump
Ernest Johnson
Steve Olea
Janice Alward
Lyn Farmer
Rebecca Wilder