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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

**COMMISSIONERS**

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2011 DEC -2 P 3: 55

DOCKETED

DEC 2 2011

AZ CORP COMMISSION  
DOCKET CONTROL

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IN THE MATTER OF THE APPLICATION OF )  
TUCSON ELECTRIC POWER COMPANY FOR )  
APPROVAL OF ITS 2011-2012 ENERGY )  
EFFICIENCY IMPLEMENTATION PLAN. )

DOCKET NO. E-01933A-11-0055

**TUCSON ELECTRIC POWER COMPANY'S  
EXCEPTIONS TO STAFF'S PROPOSED ORDER**

Tucson Electric Power Company ("TEP" or the "Company"), through undersigned counsel, hereby submits these exceptions to the Proposed Order submitted in this docket by the Utilities Division Staff ("Staff") of the Arizona Corporation Commission ("Commission") on November 16, 2011 regarding TEP's 2011-2012 Energy Efficiency Implementation Plan ("2011-2012 EE Plan").

**I. Summary of TEP's Exceptions.**

In its Electric Energy Efficiency Rules, A.A.C. R14-2-2401, *et seq.* ("EEE Rules"), the Commission has mandated reductions in TEP's retail electric sales. Those mandatory reductions will reach a cumulative level of 5% of retail sales before TEP's next rate case order. As a result, TEP will lose an estimated \$39 million of revenues between now and the end of 2013 solely due to mandated compliance with the EEE Rules. The \$39 million of lost revenues ("lost fixed cost revenues") are some of the revenues intended to cover TEP's fixed costs under TEP's 2008 Rate Case Settlement Agreement, which was approved in Decision No. 70628 (December 1, 2008) ("2008 Rate Case Settlement Order"). Since the 2008 Rate Case Settlement Agreement was entered into and approved prior to the Commission opening a docket to address energy efficiency, it did not take into account the reduced usage subsequently required by the Commission in the EEE rules.

1           The EEE Rules rulemaking process (and related order) and the Commission's Decoupling  
2 Policy Statement both recognize the need to provide for utility recovery of those lost fixed cost  
3 revenues. Indeed, Statement 3 of the Decoupling Policy Statement provides that "[s]ome form of  
4 decoupling or alternative for addressing financial disincentives *must be adopted* in order to  
5 encourage and enable aggressive use of demand side management programs and the achievement  
6 of Arizona's Electric and Gas Energy Efficiency Standards, which will benefit ratepayers and  
7 minimize utility costs."<sup>1</sup> However, the \$39 million in lost fixed cost revenues notwithstanding,  
8 Staff's Proposed Order simply defers any consideration of recovery to TEP's next rate case  
9 without providing any means for TEP to recover its lost fixed cost revenues in the interim.  
10 Without recovery of the lost fixed cost revenues (which amounts to a *de facto* rate decrease), the  
11 Proposed Order recommends a course of action that is: i) inconsistent with purpose and intent of  
12 the Commission's own Decoupling Policy Statement, and ii) violates TEP's 2008 Rate Case  
13 Settlement Order and is therefore confiscatory, and is inconsistent with the Commissions  
14 obligations under the Arizona Constitution to set just and reasonable rates and its obligations  
15 under the United States and Arizona Constitution to allow the Company to recover its costs and  
16 earn a reasonable return on its investments.

17           In order to avoid its confiscatory impact, the Proposed Order must be amended as follows:

18           1.       TEP requests that the Commission approve the Authorized Revenue Recovery  
19 True-up mechanism ("ARRT") that TEP proposed in connection with its 2011-2012 EE Plan.  
20 This mechanism will prevent TEP from suffering the adverse financial impacts of complying with  
21 the EEE Rules and allow TEP to recover revenue associated with its fixed costs that were  
22 authorized in the 2008 Rate Case Settlement Order.

23           2.       If the Commission is not inclined to provide for recovery of lost fixed cost  
24 revenues through the ARRT, then, consistent with the alternative request originally made in TEP's  
25 EE Plan Application, TEP requests a waiver from the EEE Rules and a change in its budget and  
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<sup>1</sup> Emphasis added.

1 implementation of its Demand Side Management (“DSM”) program until a lost fixed cost revenue  
2 recovery mechanism for TEP is adopted by the Commission.

3 3. If TEP is not provided relief from the adverse financial impact of complying with  
4 the Commission’s EEE Rules through amendment to the Proposed Order as set forth above, TEP  
5 requests that it be provided due process through an evidentiary hearing on its proposed 2011-2012  
6 EE Plan.

7 4. In addition to the need to remedy the failure of the Proposed Order to address the  
8 confiscatory impact of complying with the EEE Rules, TEP requests the Commission to amend  
9 the Proposed Order to:

- 10 a. Update TEP’s Performance Incentives so that they encourage program  
11 efficiency and savings, and not program spending;
- 12 b. Reject Staff’s unilateral proposal to adopt undefined DSM cost-benefit  
13 methodologies and input values and require continuing the on-going dialog  
14 between Staff and affected utilities regarding the appropriate  
15 methodologies and values; and
- 16 c. Correct the DSM Surcharge to reflect the actual effective date of the 2012 Plan.

17 TEP has provided proposed language for amendments in **Exhibit A** to these Exceptions.

## 18 **II. Background on TEP’s 2012 EE Plan and Its Impact on TEP Revenues.**

19 The EEE Rules **require** utilities to reduce their energy sales. The EEE Rules are the latest  
20 in a series of Commission rules that are intended to change the way (i) utilities provide electric  
21 service; and (ii) customers and consumers pay for electricity. For example, in addition to the EEE  
22 Rules, in recent years, the Commission has also promulgated separate sets of rules and issued  
23 decisions regarding Demand Side Management, Renewable Energy and Net Metering. These  
24 rules and orders result in reductions to the volume of sales to existing customers. This series of  
25 regulatory mandates has presented significant challenges to utilities to operate safe and reliable  
26 systems and still have a reasonable opportunity to recover their authorized rate of return on their  
27 investment in those operations.

1 Under the EEE Rules, TEP is required to sharply reduce its retail sales by:

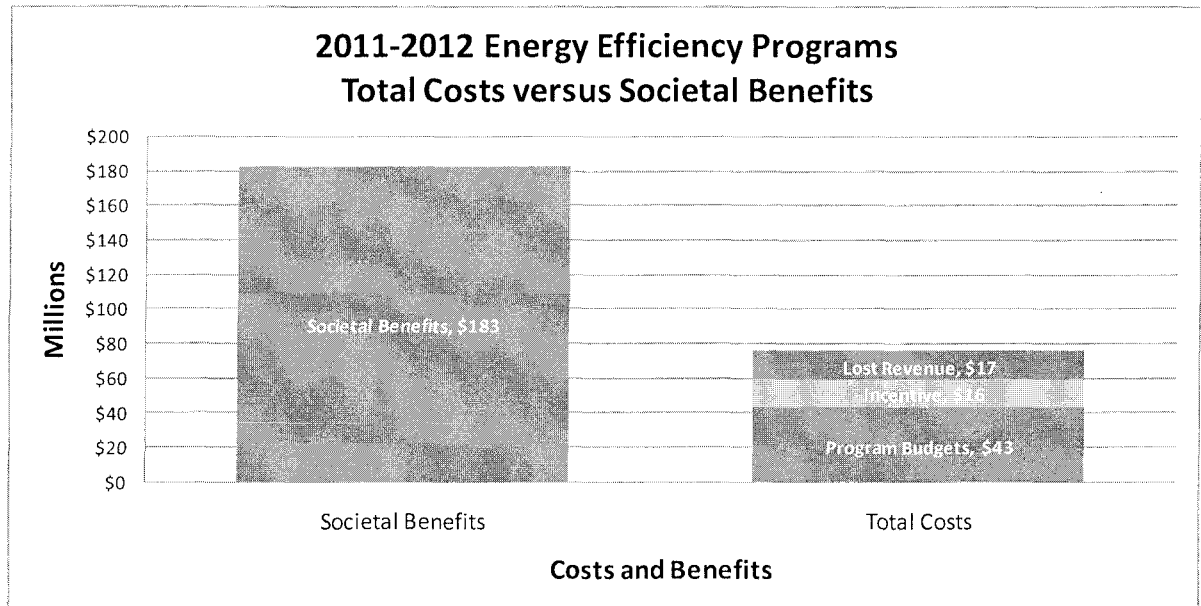
- 2 • 1.25% in 2011,
- 3 • a cumulative 3.0% in 2012, and
- 4 • a cumulative 5.0% in 2013 through the use of customer energy efficiency  
5 programs.

6 Successful implementation of any cost-effective DSM program will necessarily result in  
7 loss of revenue from those reduced kWh sales until the reduced sales are reflected in the  
8 Company's base rates in a new rate case. This occurs because TEP has an energy-based (per  
9 kWh), charge to collect fixed utility costs. Under TEP's rate design, for every 1.0% reduction in  
10 retail energy sales, its fixed cost recovery is reduced by 0.6%. Therefore, by 2013, TEP will be  
11 facing a decrease in revenues of 3.0% (5.0% x 0.6) from the effects of EEE Rule compliance.

12 This situation is further exacerbated for TEP because its base rates are frozen until January  
13 1, 2013 as part of a Commission approved 2008 Rate Case Settlement Order. In other words, TEP  
14 is precluded from updating its base rates to reflect the Commission -mandated lower sales  
15 volumes until 2013. TEP estimates that, without any recovery mechanism, it will lose \$39 million  
16 in fixed cost recovery from 2011 through 2013 if TEP is required to comply with the EEE Rules.

17 None of this is meant to imply that cost-effective energy efficiency is not a reasonable  
18 resource; indeed, TEP's customers will realize significant benefits from the EE programs. The  
19 problem is that, under Staff's Proposed Order, the reduced cost recovery associated with these  
20 customer benefits are imposed on TEP without any opportunity for recovery. The EEE Rules  
21 specifically require cost effective EE programs - and the average benefit/cost ratio for TEP's  
22 proposed EE programs is 2.6. Thus, TEP's customers will realize benefits of an estimated \$183  
23 million from full implementation of the 2011-2012 EE Plan. However, these substantial financial  
24 benefits to customers come at considerable cost to TEP. These costs include program  
25 implementation costs and lost fixed cost revenues associated with lower sales levels attributable to  
26 the EEE Rules mandates. Both traditional ratemaking theory and the Arizona Constitution require  
27 the Commission to allow TEP to recover its reasonable and prudent costs. As shown in the chart

1 below, the substantial consumer benefits (more than \$183 million) provided by TEP's 2011-2012  
2 EE Plan, far outweigh TEP's overall costs (implementation, incentives and lost fixed cost  
3 revenues recovery) that the Company requested in its 2011-2012 EE Plan:



15 In the Decoupling Policy docket (Docket Nos. E-00000J-08-0314 and G-00000C-08-  
16 0314), the Commission recognized that EE programs can be very cost-effective, providing  
17 significantly more benefits to customers than the programs themselves cost. It also acknowledged  
18 the adverse impact of energy efficiency programs on a utility's ability to recover its fixed costs of  
19 service. In order to align utility and consumer interests to accomplish the energy efficiency  
20 requirements, there must be a mechanism that allows and synchronizes a utility's ability to recover  
21 its lost fixed cost revenues. This recognition was the very impetus behind the development of the  
22 Commission's Decoupling Policy Statement.

23 In the EEE Rules Docket, TEP specifically commented and advocated that procedures for  
24 approval of a lost fixed cost revenue adjustment mechanism for the utility must first be established  
25 *before* the utility should be required to comply with the new the new EEE Rules. TEP requested  
26 that either the adoption of the EEE Rules should be delayed, or a waiver of the EEE Rules should  
27 be granted until such time that the Commission held a proceeding for the utility to establish the

1 lost fixed cost revenue recovery mechanism. Additionally, TEP requested that an evidentiary  
2 hearing on the proposed EEE Rules should be conducted before their adoption so that TEP and  
3 other interested parties could put direct evidence into the record specifically on the issue of lost  
4 fixed cost revenues. In both instances, the Commission denied TEP's request, but gave assurances  
5 that this issue would be resolved before the Company would be adversely financially impacted by  
6 the EEE Rules. TEP relied on these assurances in deciding not to appeal the EEE Rules (as  
7 confiscatory and requiring a *de facto* rate decrease without a rate case), and in continuing to  
8 promote energy efficiency through its existing Commission-approved energy efficiency programs  
9 and has otherwise complied with the EEE Rules. Clearly, Staff's recommendation to defer  
10 consideration of the lost fixed cost revenue issue until TEP's next rate case is inconsistent with the  
11 assurances that TEP justly relied upon.

12 This is TEP's first Plan under the new EEE Rules and it is critical that the Commission  
13 provide TEP with the protections contemplated in the EEE Rules docket and Decoupling Policy  
14 Statement.

### 15 **III. Specific Exceptions.**

#### 16 **A. The Commission Should Protect TEP from the Lost Revenue Impact of the** 17 **Commission-Mandated Energy Efficiency Programs.**

18 As set forth above, implementing the Commission's aggressive EEE Rules standard has  
19 and will result in significant lost fixed cost revenues to TEP and infringe upon the Company's  
20 opportunity to recover its fixed costs and earn its Commission-authorized rate of return. TEP  
21 desires to meet the mandates of the EEE Rules, but in a manner that is not confiscatory to the  
22 Company. TEP's fixed costs are currently being recovered in part through per kWh charges.  
23 Requiring TEP to decrease the number of kWh sold without a corresponding mechanism in place  
24 to allow a reasonable opportunity to recover TEP's prudently incurred fixed costs will result in  
25 unjust and unreasonable rates in violation of Article 15, Section 2 of the Arizona Constitution.  
26 TEP has always been supportive of the societal goals of the EEE Rules, but TEP is entitled to a  
27 mechanism that provides a reasonable opportunity for the Company to recover the cost of meeting

1 the EEE Rules (including fixed cost shortfalls). An effective mechanism to recover shortfalls in  
2 the recovery of fixed costs in a timely manner is critical (and legally required) for the successful  
3 execution of the EEE Rules Standard.

4 In order to meet the EEE Rules, TEP filed its 2011-2012 EE Plan over 10 months ago on  
5 January 31, 2011. In TEP's 2011-2012 EE Plan, consistent with the Commission's Decoupling  
6 Policy Statement, TEP proposed the implementation of a bridge mechanism that was narrowly  
7 tailored to allow TEP to recover the loss of its Commission-authorized fixed cost revenue due to  
8 mandated kWh reduction in compliance and its specific circumstances, including a rate  
9 moratorium, with the EEE Rules – the ARRT. TEP's proposal synchronizes the adverse revenue  
10 impacts of meeting the EEE Rules with a mechanism to recover the associated lost fixed cost  
11 revenues in an equitable manner. Without this bridge mechanism, TEP will be unable to recover  
12 of a portion of its authorized revenue requirement, which was deemed just and reasonable by the  
13 Commission in Decision No. 70628.

14 The Proposed Order directly interferes with TEP's opportunity to recover its authorized  
15 revenue requirement. Without amendment, the Proposed Order is confiscatory, violates the 2008  
16 Rate Case Settlement Order, and is inconsistent with the Commission's constitutional requirement  
17 to provide the utility with a reasonable return in setting rates. Under both the United States  
18 Constitution and the Arizona Constitution, the Commission is required to allow regulated utilities  
19 rates sufficient to meet their operating costs and earn a reasonable return on the value of their  
20 property or investment.

21 Under the Arizona Constitution, this requirement is embodied in Article 15, Section 3,  
22 which requires the Commission to set "just and reasonable rates and charges to be made and  
23 collected, by public service corporations within the state for service rendered therein..." Ariz.  
24 Const. art. XV, § 3. Notably, Section 3 speaks of rates "collected" by the utility – the utility must  
25 actually have a reasonable opportunity to collect the revenue requirement authorized by the  
26 Commission.

27

1 Arizona constitutional law requires that the “rates established by the Commission should  
2 **meet the overall operating costs** of the utility and produce a reasonable rate of return.” *Consol.*  
3 *Water Utilities, Ltd. v. Arizona Corp. Comm'n*, 178 Ariz. 478, 482, 875 P.2d 137, 141 (Ct. App.  
4 1993)(emphasis added)(quoting *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d  
5 612, 615 (Ct. App.1978)). Thus, any action by the Commission which prevents the utility from  
6 collecting rates sufficient to “meet...overall operating costs” or produce a reasonable rate of return  
7 would violate the Commission’s obligations under the Arizona Constitution.

8 In other words, “total revenue, including income from rates and charges, should be  
9 sufficient to meet a utility's operating costs and to give the utility and its stockholders a reasonable  
10 rate of return on the utility's investment.” *Residential Util. Consumer Office v. Arizona Corp.*  
11 *Comm'n*, 199 Ariz. 588, 591, 20 P.3d 1169, 1172 (Ct. App. 2001) (quoting *Scates v. Arizona*  
12 *Corp. Comm'n*, 118 Ariz. at 533-34, 578 P.2d at 614-15). Here, the Commission’s EE Rules  
13 require a reduction in sales, and thus a reduction in revenue, ensuring that “total revenue” will not  
14 “be sufficient to meet” operating costs and provide a reasonable return.

15 In short, Arizona courts have held over and over again that the Commission must set rates  
16 “to allow a recovery for all reasonable expenses, plus a return on investment (rate base).” *Tucson*  
17 *Elec. Power Co. v. Arizona Corp. Comm'n*, 132 Ariz. 240, 245, 645 P.2d 231, 236 (1982); see also  
18 *Consol. Water Utilities, Ltd., supra*; *Residential Util. Consumer Office, supra*; *Scates, supra*. If  
19 anything, that obligation is even stronger when the expenses are made to comply with  
20 Commission mandates. Cf. *Arizona Corp. Comm'n v. Palm Springs Util. Co., Inc.*, 24 Ariz. App.  
21 124, 130, 536 P.2d 245, 251 (1975) (Commission “must consider” expenses of complying with  
22 Commission decision when setting rates).<sup>2</sup>

23  
24 <sup>2</sup> The United States Constitution imposes a similar requirement on the Commission. As the United States  
25 Supreme Court explained:

26 [T]he Constitution protects utilities from being limited to a charge for their property  
27 serving the public which is so “unjust” as to be confiscatory.... If the rate does not  
afford sufficient compensation, the State has taken the use of utility property without  
paying just compensation and so violated the Fifth and Fourteenth Amendments.



1 The Proposed Order (and related Staff Report) simply does not address these concerns.  
2 summarily defers the issue of lost revenue recovery to TEP's next rate case and would result in  
3 unjust and unreasonable rates in violation of the 2008 Rate Settlement Order and the Arizona and  
4 United States Constitutions.

5 **1. The Commission should approve TEP's proposed Authorized Revenue**  
6 **Requirement True-Up Mechanism.**

7 The issue of synchronizing a revenue recovery mechanism with the implementation of the  
8 EEE Rules is critical and must be resolved in this proceeding. The Commission's Decoupling  
9 Policy Statement accurately states "[t]he Commission believes it is critical that utility  
10 disincentives to demand side management programs and energy efficiency be addressed. As  
11 stakeholders recognized, it is unlikely that the EES can be met without addressing financing  
12 disincentive and impacts to utilities' revenues and earnings."<sup>3</sup>

13 The proposed ARRT is a straightforward mechanism *which* has been described by TEP in  
14 numerous Energy Efficiency workshops and decoupling discussions over the past three years. The  
15 ARRT is a focused mechanism that recovers *only* the revenue requirement (non-fuel fixed costs)  
16 associated with the incremental energy efficiency kWh savings from the EE Standard starting in  
17 2011, by multiplying these savings by the applicable Commission-approved non-fuel rates from  
18 TEP's last rate case. TEP is proposing this mechanism as a bridge that will only remain in effect  
19 until approval of a revenue decoupling, or similar mechanism, in its next rate case. Moreover, the  
20 Commission can review the funds collected under the ARRT and true-up the recovery in the next  
21 rate case.

22 Staff summarily dismisses the ARRT by simply asserting that a lost revenue recovery  
23 mechanism can only be set in a rate case, referring to Rule 2410(I). However, Staff takes an  
24 unduly narrow interpretation of the EEE Rules.

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26 *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-08 (1989).

27 <sup>3</sup> Commission's Decoupling Policy Statement at page 27 (emphasis added.)

1 Rule 2410(I) states:

2 The Commission **shall review and address** financial disincentives, recovery of  
3 fixed costs, and recovery of net lost income/revenue, due to Commission-  
4 approved DSM programs, **if an affected utility requests such review in its rate  
case** and provides documentation/records supporting its request in its rate  
5 application. A.A.C. R14-2-2410(I)(emphasis added)

6 By its plain language, Rule 2410(I) imposes a requirement on the Commission – if the utility  
7 request such a review in a rate case, the Commission “shall review and address financial  
8 disincentives, recovery of fixed costs, and recovery of net lost income/revenue.” The rule does not  
9 state that a rate case is the only place such issues may be considered, nor does it prohibit a utility  
10 from raising – or the Commission from addressing – such issues outside of a rate case. Instead,  
11 the rule merely requires that if a utility raises these issues in a rate case, the Commission must  
12 “review and address” the issues.

13 Moreover, Rule 2410(I) contemplates that the utility may, in fact, actually file a rate case.  
14 That is not the case for TEP – it is under an extended rate case moratorium. Thus, TEP’s situation  
15 is not a situation addressed or contemplated by Rule 2410(I).

16 The Commission has now adopted the Decoupling Policy Statement. In that Policy  
17 Statement, the Commission has expressly stated that “[s]ome form of decoupling or alternative for  
18 addressing financial disincentives must be adopted in order to encourage and enable aggressive  
19 use of demand side management programs and the achievement of Arizona’s Electric and Gas  
20 Energy Efficiency Standards, which will benefit ratepayers and minimize utility costs.”<sup>4</sup> The  
21 Decoupling Policy Statement also does not restrict the adoption of a decoupling mechanism to a  
22 rate case.

23 Thus, while Rule 2410(I) requires the Commission to “review and address” fixed cost  
24 recovery issues caused by Commission-mandated EE programs, the rule does not prohibit the  
25 Commission from addressing the issue outside a rate case. Moreover, TEP is in a rate moratorium  
26 – a situation not contemplated or addressed in Rule 2410(I).

27 \_\_\_\_\_  
<sup>4</sup> Commission’s Decoupling Policy Statement 5.

1 But even if Rule 2410(I) did somehow restrict lost revenue recovery issues to a rate case,  
2 there is nothing that precludes the Commission from modifying or waiving the effect of a  
3 Commission rule in a utility specific order. Indeed, the EEE Rules specifically contemplate  
4 waivers, providing that the “Commission may waive compliance with any provision of this Article  
5 for good cause.” A.A.C. R14-2-2419(A). In light of the significant and deleterious impact (\$39  
6 million) to the Company in complying with the EEE Rules, the Commission should err on the side  
7 of resolving this issue now, as opposed to putting resolution of this issue off until the next TEP  
8 rate case.

9 Article 15, Section 3 of the Arizona Constitution provides that the Commission has “full  
10 power to, and shall, prescribe just and reasonable classifications to be used and just and reasonable  
11 rates and charges to be made and collected by public service corporations within the State for  
12 services rendered therein.” The Commission has broad discretion in its determination of just and  
13 reasonable rates, subject to the obligation to ascertain the fair value of the utility’s property and  
14 establish rates that “meet the overall operating costs of the utility and produce a reasonable rate of  
15 return.”<sup>5</sup> Neither the Arizona Constitution nor the Courts mandate that the Commission employ a  
16 particular method in setting rates or exclude consideration of all relevant factors; and the  
17 Commission’s authority extends to every step of ratemaking.<sup>6</sup>

18 The Commission’s Decoupling Policy Statement recognizes that traditional ratemaking  
19 would not necessarily be sufficient to allow utilities to recover their fixed costs if they were  
20 experiencing ongoing declines in usage and revenue per customer due to compliance with  
21 mandated Commission programs. The ARRT is designed to meet the revenue requirement  
22 established by the Commission in the 2008 Rate Case Settlement Order, allowing TEP to meet its  
23 Commission-approved prudent operating costs and produce a reasonable rate of return through the  
24 DSM adjustor mechanism approved by the Commission in the Rate Case Settlement Order,  
25 subject to true-up in the next rate case. Under these circumstances, and contrary to Staff’s  
26

27 <sup>5</sup> *Scates* at 118, Ariz. 531, 534, 578 P.2d.612, 615.

<sup>6</sup> *See Simms v. Round Valley Power & Light, Co.* 80 Ariz. 145, 294 P.2d 378, 384 (1956),

1 assertion in the Proposed Order that “lost revenues can only be addressed during a rate case”<sup>7</sup>,  
2 there is no legal justification that precludes the Commission approving the ARRT in this  
3 proceeding.

4 The ARRT is consistent with the intent of lost revenue recovery contemplated by the  
5 Decoupling Policy Statement and the EEE Rules. It aligns both consumer and TEP interests in  
6 meeting the Commission-mandated EEE Rule Standard. It also provides the Company with the  
7 opportunity to recover authorized revenues on a timely basis, mitigates the financially adverse  
8 impacts of regulatory lag and ameliorates the unfortunate timing of the adoption of the EEE Rules  
9 while TEP is in a rate case moratorium. The significant benefits accruing to TEP’s customers  
10 from implementing the EEE Standards while maintaining TEP’s financial health constitutes good  
11 cause for the Commission to adopt TEP’s proposed mechanism now. The Societal Benefits that  
12 are achieved through TEP’s 2011-2012 EE Plan far exceed the costs proposed by TEP. TEP’s  
13 2011-2012 EE Plan will result in the avoidance of over \$180 million in generation costs that  
14 would otherwise be borne by TEP’s customers. There is no reason to delay its implementation  
15 based on an unduly narrow reading of the EEE Rules that is inconsistent with the Commission’s  
16 Decoupling Policy Statement, especially in light of the true-up that will occur in the next rate case.

17 **2. Alternatively, the Commission should grant TEP a waiver from**  
18 **compliance with the EE Rules until TEP’s next rate case.**

19 If the Commission does not approve the ARRT, then TEP requests a waiver from meeting  
20 the EEE Rules pursuant to A.A.C. R14-2-2419 until the conclusion of TEP’s next rate case. At  
21 that time, an appropriate decoupling mechanism or other solution can be approved and  
22 synchronized with the impacts of future compliance with the EEE Rules. Given the rate case  
23 moratorium in the 2008 TEP Rate Settlement Order, TEP’s next rate case may be concluded in  
24 2013.

25 In the interim, TEP believes it would be appropriate to continue collecting the currently  
26 approved DSM Surcharge but modify DSM/EE program spending in such a way that the currently  
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<sup>7</sup> Proposed Order at Finding of Fact No. 250.

1 approved DSMS will cover: (i) a reduced 2012-2013 program spending level; (ii) the under-  
2 collection of program spending to date; and (iii) the currently- approved performance incentive.  
3 The DSM Surcharge would cover most existing approved DSM programs as of 2010, with some s  
4 modification to spending levels and delivery mechanisms. **Exhibit B** sets forth the DSM  
5 Programs that would continue to be funded through the DSM Surcharge.

6 The proposed waiver will significantly ameliorate the undue imposition of an unfunded  
7 mandate upon TEP until an appropriate decoupling mechanism is approved. Even at these  
8 proposed levels, TEP will continue to lose revenue and the opportunity to recover fixed costs.  
9 However, TEP believes it is important to not wholly disrupt the operation of its approved and  
10 active DSM Programs. Still, TEP realizes there will be unfortunate negative impacts of stepping  
11 down from the current 2010 approved program budget of \$14 Million and not increasing to the  
12 recommended program budget of \$24 Million. Negative impacts from reduced program spending  
13 include:

- 14 1. Reducing energy savings.
- 15 2. Severely limiting TEP's ability to offer programs and measure options that reach  
16 all utility customer sectors and will also significantly lower overall customer  
17 participation.
- 18 3. Exposing ratepayers to higher potential rate impacts by limiting TEP's ability to  
19 defer new generation.
- 20 4. Exposing ratepayers to additional or duplicate DSM/EE program start-up and  
21 marketing costs required to re-staff, re-train and rebuild market share for programs  
22 that are scaled down, and then ramped back up.
- 23 5. Reducing the cost effectiveness for similar programs co-delivered by TEP and  
24 UES.
- 25 6. Causing the loss of well-trained program staff and adversely affecting TEP's ability  
26 to secure future staffing, contractors and consumer goodwill.

27 Finally, in adopting the EEE Rules with a specific waiver provision, the Commission  
recognized that there may be circumstances whereby a waiver of compliance with the EEE Rules  
might be necessary "for good cause." In light of: (i) the timing of the adoption of the EEE Rules

1 in relation to the adoption of the Decoupling Policy Statement; ( ii) the inconsistency between  
2 EEE Rules and the Decoupling Statement in relation to the approval of decoupling mechanisms;  
3 (iii) the unique fact that TEP is subject to the 2008 Rate Case Settlement Order which precludes  
4 the Company from filing a rate case any earlier than July 1, 2012; and (iv) the estimated \$39  
5 million impact to the Company if this issue is not resolved now, the record in this case establishes  
6 that good cause exists for the waiver.

7 **3. Without amendment or waiver, TEP requests a hearing on its 2011-  
2012 EE Plan.**

8 The Proposed Order reflects Commission Staff's position on TEP's proposed 2011-2012  
9 EE Plan. The Proposed Order as written is unacceptable to TEP and would constitute a *de facto*  
10 revenue decrease that would last until TEP's next rate case. Such action is confiscatory in  
11 violation of the United States and Arizona Constitutions, is contrary to the 2008 Rate Case  
12 Settlement Order, and results in unjust and unreasonable rates for TEP in violation of the  
13 Commission's constitutional obligations. TEP has proposed amendments that would ameliorate  
14 those illegal impacts. However, if the Commission is not prepared to amend the Proposed Order  
15 at this time, then TEP respectfully demands an evidentiary hearing on its 2012 EE Plan in order to  
16 exercise its due process rights before the Commission adopts an order regarding TEP's 2012 EE  
17 Plan Application.<sup>8</sup> The hearing will allow TEP to present additional evidence regarding, among  
18 other things, the fixed cost revenue it will lose and the confiscatory and unconstitutional nature of  
19 the proposed order as written.

20 **B. The Commission should update the Performance Incentives for TEP to Incent  
21 Savings and Program Effectiveness, not Spending.**

22 In its 2011-2012 EE Plan, TEP requested to modify its current performance incentive so  
23 that it would encourage cost savings and efficiency and put it more in line with the industry's best  
24 practices regarding such incentives. In contrast, TEP's current performance incentive is designed  
25 to reward utilities for greater spending, which TEP believes is the wrong signal for performance  
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27 <sup>8</sup> TEP had previously requested an evidentiary hearing before the EEE Rules were adopted and the  
Commission denied this request.

1 incentives. Staff, however, has summarily rejected the proposed modification without addressing  
2 their merits and benefits. Rather Staff (and the Proposed Order) states only that “it is not  
3 appropriate for a reset outside a rate case to include major changes to the type or level of costs  
4 recovered through the DSM adjustor. Changes to the adjustor, including changes to how the  
5 Performance Incentive is calculated, should be made within a rate case.”<sup>9</sup>

6 Contrary to Staff’s statement, Section R14-2-2411 of the EEE Rules specifically provides  
7 for a modification of the performance incentive *in the annual Implementation Plan* to encourage  
8 and reward the utility for achieving the energy efficiency standard:

9 “In the implementation plans required by R14-2-2405, an affected utility may  
10 propose for Commission review a performance incentive to assist in achieving the  
11 energy efficiency standard set forth in R14-2-2404. The Commission may also  
12 consider performance incentives in a general rate case.”

12 The EEE Rules specifically state that it is appropriate for the Commission to review the  
13 performance incentive when requested by an affected utility. Further, the EEE Rules acknowledge  
14 the performance incentives may also be addressed in a rate case, but they do not require it. And  
15 here, where the proposed modification results in a more cost effective performance incentive, the  
16 Commission should not delay such modifications until a future rate case.

17 The structure of TEP’s current performance incentive was approved in TEP’s last rate case,  
18 in Decision No. 70628 (December 1, 2008). The current performance incentive is structured to  
19 allow TEP to collect 10% of the net benefits from the DSM portfolio, excluding the Lower Income  
20 Weatherization (“LIW”), Education and Outreach (“E&O”) and Direct Load Control Programs,  
21 but is capped at 10% of DSM spending with no variation in the amount of incentive based on  
22 TEP’s meeting or exceeding EE Standards. This incentive structure as currently designed  
23 ultimately rewards utilities for greater spending, which TEP believes is the wrong signal for  
24 performance incentives. TEP is proposing to continue using shared incentives based on “net  
25 benefits,” but proposes to modify the performance incentive structure. As shown in the table  
26

27 \_\_\_\_\_  
<sup>9</sup> Staff Report at 47-48 (emphasis added).

1 below, this proposal reduces the percent share of net-saving and places a hard dollar cap based on  
2 10% of net benefits rather than a cap on percent of spending.

Achievement of EE Goals	% of Lifetime Net Benefits
<85%	5%
85% - 95%	6%
96% - 105%	7%
106% - 115%	8%
116% - 125%	9%
>125%	10% (cap below)
Dollar Cap (2011 and 2012)	\$13,154,667

3  
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9  
10 This structure is preferable over the percent spending cap because it encourages cost  
11 savings rather than increased spending to increase the performance incentive. The proposed tiered  
12 performance incentive encourages performance over and above the established EE Standard and  
13 rewards utilities for this performance if accomplished at a lower cost. This model creates an  
14 atmosphere where utilities will place more emphasis on programs with the best cost-effectiveness  
15 and the highest net-benefits. To truly capture the performance incentive TEP is requesting  
16 approval for an after-tax performance incentive.

17 The performance incentive requested by TEP is well within the best practice performance  
18 incentive levels approved for other utilities and the current incentive structure is well below best  
19 practice performance incentive levels approved for other utilities. TEP's proposed modifications  
20 result in performance incentives that are comparatively less than that of other investor-owned  
21 utilities that have a shared benefits performance incentive structure.

22 Accordingly, the Company requests that the Proposed Order be amended to allow the  
23 requested tiered performance structure based on a cap of 10% of net benefits.

24 In sum, TEP believes it is important to immediately adopt TEP's proposed modified  
25 performance incentives that encourage program efficiency and saving, not program spending.  
26  
27



1           **C.     The Commission Should Reject Staff's Cryptic Proposal Concerning**  
2           **Calculating Cost Effectiveness.**

3           In the Proposed Order – and without any explanation or analysis -- Staff is asking the  
4 Commission to require “that, in all future DSM Implementation Plans, the Company use the same  
5 input values and methodology as Staff for calculating the present value benefits and costs to  
6 determine benefit-cost ratios.”<sup>10</sup> Staff’s recommendation is troubling in that it does not identify  
7 what it believes are appropriate input values and methodologies. However, it is important to note  
8 that, for some time, there has been an ongoing dialog between Commission Staff and affected  
9 utilities concerning the appropriate input values and methodologies. Staff’s summary  
10 recommendation effectively circumvents that dialog and quashes participation by affected utilities  
11 and other interested parties.

12           TEP recognized in 2009 that there were numerous inconsistencies in the methodology that  
13 affected utilities used to calculate present value benefits and costs to determine benefit-cost ratios  
14 using the Societal Cost Test (“SCT”) and the methodology used by Staff. TEP initiated meetings  
15 with Staff to identify differences in the methodologies and requested Arizona Public Service  
16 Company (“APS”) to include this issue in DSM Collaborative meetings. APS scheduled DSM  
17 Collaborative meetings on February 5, 2010 and May 18, 2010, to begin the process of  
18 establishing a common framework between APS, TEP, UNS Electric (“UNSE”) and Commission  
19 Staff for calculating benefit-costs of DSM activities and a white –paper was published on October  
20 1, 2010 outlining the results and findings. TEP, UNSE and APS were unable to resolve the seven  
21 (7) major differences with Staff which would have enabled a consistent approach between the  
22 utilities and Staff for calculating the benefit-cost ratios on DSM/EE Programs.

23           Accordingly, the Company requests that the Proposed Order be amended to eliminate  
24 Staff’s recommendation and to allow TEP, UNSE APS, other affected utilities and interested  
25 parties to continue workshops and develop a proposed resolution of the appropriate methodologies  
26

27 \_\_\_\_\_  
<sup>10</sup> Proposed Order at page 59, lines 1-4.

1 and input values.

2 **D. The Commission must correct the DSM Adjustor to accurately reflect the**  
3 **actual effective date of the 2012 EE Plan.**

4 In the Proposed Order, Staff has mistakenly calculated the DSM surcharge using a 15-  
5 month collection period. This calculation assumes that the 2012 EE Plan would be approved in  
6 September, 2010. However, given the timing of approval of the 2012 EE Plan, the DSM  
7 surcharge will be collected over only a 12-month period. Therefore, the DSM surcharge must be  
8 corrected by calculating it based on a 12-month collection period.

9 **IV. Relief Requested.**

10 In order to ensure just and reasonable rates that are in the public interest, TEP requests that  
11 the Commission amend the Proposed Order as set forth in these Exceptions. Without amendment,  
12 the Proposed Order effectively imposes a rate decrease on TEP, violates the 2008 Rate Case  
13 Settlement Order, and results in an improper confiscatory action by the Commission in violation  
14 of the Commission's Constitutional obligations.

15 If the Commission is not inclined to amend the Proposed Order at this time (either through  
16 adoption of the ARRT or granting a waiver of the EEE Rules), then TEP hereby requests the  
17 Commission to defer its vote on the Proposed Order in this docket until such time that an  
18 evidentiary hearing on TEP's proposed 2012 Energy Efficiency Implementation Plan could be  
19 conducted so that the Company has an opportunity to exercise its due process rights

20 RESPECTFULLY SUBMITTED this 2nd day of December 2011.

21 Tucson Electric Power Company

22  
23 By \_\_\_\_\_  
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By



EXHIBIT

"A"

## Proposed Amendment Language

### ARRT Amendment and Related Amendments

At Page 57, line 10, **REPLACE** paragraph 249 with:

“249. TEP’s proposed performance incentive is tied to cost effective programs and actual benefits from those programs. This incentive is superior to the to the current performance incentive, which is tied to program spending regardless of actual effectiveness of that spending. Therefore, we will approve TEP’s proposed performance incentive as set forth in its Implementation Plan.”

At Page 57, line 19, **REPLACE** paragraphs 250 and 251 with:

“250. ARRT. The ARRT Mechanism proposed by TEP is designed to recover revenue intended to cover fixed costs that has been lost due to the implementation of the EE Standard. The ARRT is consistent with our Decoupling Policy Statement and provides appropriate synchronization of lost fixed cost revenue recovery with the TEP EE Implementation Plan. Therefore, we will approve the ARRT Mechanism.”

At Page 57, line 26, **REPLACE** paragraphs 252 and 253 with:

“251. DSMS Reset Level. The current DSMS is \$0.001249 per kWh. In its application, TEP had requested to increase the DSMS to \$0.006343 per kWh, based on its proposals discussed herein. Based on the discussion above, including the approval of the modified performance incentive and the ARRT, and the timing of the approval the TEP 2012 Implementation Plan, the DSMS will be set at \$0.007603 per kWh.

**DELETE** Page 59, lines 1 through 4.

**DELETE** Page 68, lines 10 through 18 and **INSERT**:

“IT IS FURTHER ORDERED that the DSMS shall include: (i) the program spending approved by this Order and (ii) the modified Performance Incentive proposed by Tucson Electric Power Company in its Implementation Plan.

IT IS FURTHER ORDERED that calculation of the DSMS shall take into account the current DSMS bank balance and Tucson Electric Power Company’s ARRT Mechanism.

IT IS FURTHER ORDERED that the DSMS shall be reset to \$0.007603 per kWh.”

**DELETE** Page 69, lines 1 through 4.

Make all conforming changes.

Proposed Amendment Language

Waiver Amendment and Related Amendments

At Page 57, line 23, **REPLACE** paragraph 251 with:

“251. TEP requested that, if the ARRT is not approved, the Commission grant TEP a waiver of the Energy Efficiency Rules until the ARRT or another “adequate” remedy is in place. We agree that some form of decoupling or alternative for addressing the financial disincentives of compliance with the Energy Efficiency Rules standards must be adopted before TEP is obligated to meet those standards in order to synchronize the adverse revenue impact of the Energy Efficiency Rules and the recovery of the lost fixed cost revenues. Therefore, there is good cause to defer TEP’s obligation to comply with the Energy Efficiency Rules pursuant to A.A.C. R14-2-2419 until the Commission adopts an appropriate decoupling or alternative mechanism to address the financial disincentives for TEP. In its Exceptions, TEP provided a proposal for continuing existing approved DSM programs. TEP’s proposal is reasonable and should also be approved.”

At Page 57, line 26, **REPLACE** paragraphs 252 and 253 with:

“252. DSMS Reset Level. The current DSMS is \$0.001249 per kWh. Given the waiver we are granting to TEP herein and the DSM programs that TEP will continue until a future Implementation Plan is approved, it is reasonable to keep the DSMS at the current level.”

**DELETE** Page 59, lines 1 through 4.

**DELETE** Page 63, line 23 through page 68, line 8 and **INSERT**:

“IT IS ORDERED that Tucson Electric Power Company’s obligation to comply with the Electric Energy Efficiency Rules, A.A.C. R14-2-2401 et seq. is hereby deferred until further Order of the Commission.

IT IS FURTHER ORDERED that Tucson Electric Power Company’s proposed DSM program, at set forth in Exhibit B to its Exceptions in this docket, is hereby approved.

**DELETE** Page 68, lines 10 through 18 and **INSERT**:

“IT IS FURTHER ORDERED that the DSMS shall remain at \$0.001249 per kWh.”

**DELETE** Page 68, line 19 through Page 69, line 4.

Make all conforming changes.

EXHIBIT

"B"



## EXHIBIT B

### Proposed DMS Programs and DMS Surcharge

TEP will maintain the currently approved DSMS of \$0.001249 per kWh and continue to offer programs approved by the Commission through December 31, 2010 but will modify DSM/EE program budgets in order to cover all previously approved expenses and reduce TEP's financial losses associated with DSM/EE programs. To enable recovery of all previously approved DSM/EE costs, EE program budgets will be reduced to \$6.8 Million per year until an ARRT mechanism or decoupling is approved.

TEP will discontinue implementation of programs approved after December 31, 2010 and will not implement any new programs and measures proposed in the 2011-2012 Energy Efficiency Implementation Plan. The following programs will not be offered:

- Home Energy Reports (OPower);
- Appliance Recycling;
- Multi-Family Direct Install;
- Bid for Efficiency;
- Retro-commissioning;
- Schools Facilities;
- Behavioral Comprehensive;
- CHP Pilot;
- Residential Energy Efficiency Financing, and
- Codes Support

Continuation of DSM/EE programs using the \$6.8 Million budget request for 2012 rather than the Staff recommended budget of \$24.7 Million will not eliminate TEP's financial losses, but will lessen the burden until the next rate case is decided. TEP will strive to achieve a reasonable reduction from 2011 sales of approximately 0.7% and anticipates that a similar spending level in 2013 may allow TEP to again achieve approximately 0.7% reduction from 2012 forecasted sales. TEP's willingness to offer continuance of the 2010 approved programs with reduced budgets reflects the Company's commitment to provide residential and commercial customers with energy efficiency programs in an environment where TEP's approved expenses are also recovered in a timely manner.

Information provided in Table 1 below shows the programs TEP will continue to offer in 2012 with a comparison showing the original budget request filed in the 2011-2012 Implementation Plan and the current program budget request.

Table 1 \_ Updated 2012 IP Budget Filed August 2011 and Revised 2012 Budget

	<b>Updated 2012 Budget</b>	<b>Revised 2012 Budget</b>
<b>Support Programs</b>		
Education and Outreach	\$384,724	\$201,807
Residential Energy Financing	\$442,645	\$0
Codes Support	\$75,490	\$0
Support Programs Subtotal	\$902,859	\$201,807
<b>Behavioral Programs</b>		
Home Energy Reports	\$673,790	\$0
Behavioral Comprehensive Program	\$1,420,279	\$0
Behavioral Subtotal	\$2,094,069	\$0
<b>Residential Efficiency Programs</b>		
Low-Income Weatherization	\$616,451	\$616,451
Appliance Recycling	\$859,533	\$0
Residential New Construction	\$1,766,846	\$746,250
Existing Home	\$3,514,886	\$748,858
Shade Tree Program	\$325,582	\$93,535
Efficient Products (CFL)	\$2,431,495	\$1,361,488
Multi-Family Direct Install	\$169,738	\$0
Residential Subtotal	\$9,684,531	\$3,566,582
<b>Non-Residential Efficiency Programs</b>		
Bid For Efficiency	\$503,092	\$0
C&I Comprehensive Program	\$4,285,856	\$795,910
Small Business Direct Install	\$2,921,085	\$699,710
Commercial New Construction	\$406,319	\$250,338
CHP Joint Program (Pilot)	\$22,000	\$0
C&I Schools Program	\$157,941	\$0
Retro-Commissioning	\$175,520	\$0
Non-Residential Subtotal	\$8,471,813	\$1,745,958
<b>Demand Response Programs</b>		
Residential & Small Commercial DLC	\$184,816	\$154,239
C & I DLC	\$2,751,959	\$950,013
Demand Response Subtotal	\$2,936,775	\$1,104,252
<b>Program Totals</b>	<b>\$24,090,047</b>	<b>\$6,618,599</b>
Program Development, Analysis & Reporting Software	\$649,145	\$252,595
<b>Sub-total</b>	<b>\$649,145</b>	<b>\$252,595</b>
<b>Portfolio Total</b>	<b>\$24,739,192</b>	<b>\$6,871,194</b>

In order for TEP to offer all programs shown in Table 1 above, it is also necessary to modify the way many of the programs are delivered to customers. TEP will change program delivery from a third-party implementation contractor to program delivery using internal utility staff where it is deemed that utility staff is available with adequate knowledge and training to provide these services. Information in Table 2 below shows the changes in program delivery that will be necessary to achieve continuation of programs with reduced spending limits.

Table 2: Changes in programs for 2012

Program	Program Changes
Residential New Construction	<ul style="list-style-type: none"> <li>• Reduce budget 42%,</li> <li>• Reduce participation from 686 to 150</li> </ul>
Shade Trees	<ul style="list-style-type: none"> <li>• Reduce budget 71%,</li> <li>• Reduce participation from 2936 to 588</li> </ul>
Efficient Products	<ul style="list-style-type: none"> <li>• Modify contract with ECOVA (formerly ECOS),</li> <li>• Reduce budget 44%</li> </ul>
Existing Home	<ul style="list-style-type: none"> <li>• Cancel contracts with Conservation Services Group,</li> <li>• Loss of 9 local jobs, reduce budget 79%,</li> <li>• Reduce participation from 3283 to 584</li> </ul>
Education and Outreach	<ul style="list-style-type: none"> <li>• Reduce budget 48%,</li> <li>• Cancel elementary school education programs,</li> <li>• Cancel support for Children's Museum</li> </ul>
Home Energy Reports	<ul style="list-style-type: none"> <li>• Cancel contract with OPOWER for program delivery</li> <li>• Discontinue all current activity</li> </ul>
C&I Comprehensive	<ul style="list-style-type: none"> <li>• Cancel contract with KEMA for program delivery,</li> <li>• Loss of 3 local jobs, reduce budget 81%,</li> <li>• Reduce participation from 200 to 39</li> </ul>
Small Business	<ul style="list-style-type: none"> <li>• Cancel contract with KEMA for program delivery,</li> <li>• Loss of 2 local jobs, reduce budget 76%,</li> <li>• Reduce participation from 357 to 85</li> </ul>
Efficient Commercial Building Design	<ul style="list-style-type: none"> <li>• Cancel contract with KEMA for program delivery,</li> <li>• Loss of 1 local jobs,</li> <li>• Reduce budget 38%,</li> <li>• Reduce participation from 20 to 13</li> </ul>
Commercial Direct Load Control	<ul style="list-style-type: none"> <li>• Modify contract with EnerNOC,</li> <li>• Reduce budget 65%</li> </ul>