

ORIGINAL



0000133509

1 Timothy M. Hogan (004567)
2 ARIZONA CENTER FOR LAW
3 IN THE PUBLIC INTEREST
4 202 E. McDowell Rd., Suite 153
5 Phoenix, Arizona 85004
6 (602) 258-8850

RECEIVED

7012 JAN 18 P 3:59

AZ CORP COMMISSION
DOCKET CONTROL

Arizona Corporation Commission

DOCKETED

JAN 18 2012

DOCKETED BY

Attorneys for Southwest Energy Efficiency Project

BEFORE THE ARIZONA CORPORATION COMMISSION

7 GARY PIERCE, Chairman
8 BOB STUMP
9 SANDRA KENNEDY
10 PAUL NEWMAN
11 BRENDA BURNS

12 IN THE MATTER OF THE APPLICATION)
13 OF ARIZONA PUBLIC SERVICE COMPANY)
14 FOR A HEARING TO DETERMINE THE FAIR)
15 VALUE OF THE UTILITY PROPERTY OF THE)
16 COMPANY FOR RATEMAKING PURPOSES,)
17 TO FIX A JUST AND REASONABLE RATE)
18 OF RETURN THEREON, TO APPROVE RATE)
19 SCHEDULES DESIGNED TO DEVELOP SUCH)
20 RETURN.)

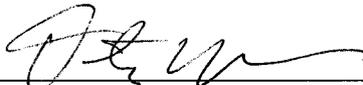
DOCKET NO. E-01345A-11-0224

NOTICE OF FILING
TESTIMONY OF JEFF
SCHLEGEL IN PARTIAL
OPPOSITION TO THE
PROPOSED SETTLEMENT
AGREEMENT

21 Southwest Energy Efficiency Project ("SWEEP"), through its undersigned counsel,
22 hereby provides notice that it has this day filed the testimony of Jeff Schlegel in partial
23 opposition to the proposed Settlement Agreement in connection with the above-captioned
24 matter.
25

1 DATED this 18th day of January, 2012.

2 ARIZONA CENTER FOR LAW IN
3 THE PUBLIC INTEREST

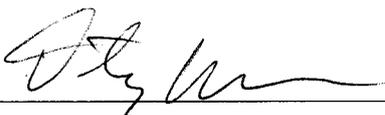
4 By 
5 Timothy M. Hogan
6 202 E. McDowell Rd., Suite 153
7 Phoenix, Arizona 85004
8 Attorneys for Southwest Energy Efficiency
9 Project

10 ORIGINAL and 13 COPIES of
11 the foregoing filed this 18th day
12 of January, 2012, with:

13 Docketing Supervisor
14 Docket Control
15 Arizona Corporation Commission
16 1200 W. Washington
17 Phoenix, AZ 85007

18 COPIES of the foregoing
19 Electronically mailed this
20 18th day of January, 2012 to:

21 All Parties of Record

22 
23 _____

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF
ARIZONA PUBLIC SERVICE COMPANY FOR
A HEARING TO DETERMINE THE FAIR
VALUE OF THE UTILITY PROPERTY OF THE
COMPANY FOR RATEMAKING PURPOSES,
TO FIX A JUST AND REASONABLE RATE OF
RETURN THEREON, TO APPROVE RATE
SCHEDULES DESIGNED TO DEVELOP SUCH
RETURN.

DOCKET NO. E-01345A-11-0224

Testimony in Partial Opposition to the Proposed Settlement Agreement of

Jeff Schlegel

Southwest Energy Efficiency Project (SWEEP)

January 18, 2012

**Testimony in Partial Opposition to the Proposed Settlement Agreement of
Jeff Schlegel, SWEEP**

Docket No. E-01345A-11-0224

Table of Contents

Introduction.....	3
Summary of SWEEP’s Testimony in Partial Opposition to the Proposed Settlement	3
Utility Financial Disincentives to Energy Efficiency and Preserving the Commission’s Ability to Consider Options and Decide Energy Policy	4
Rate Case Moratorium/Stay-Out Provision and Preserving the Commission’s Ability to Decide Energy Policy and Respond to Changing Conditions	6
Energy Efficiency Performance Incentive	7
Adequate Funding and Stability for Energy Efficiency.....	10
Accounting for Commission-Adopted Policies as an Adjustment to Sales.....	11
Conclusion	12

Introduction

1
2
3 Q. Please state your name and business address.

4
5 A. My name is Jeff Schlegel. My business address is 1167 W. Samalayuca Drive,
6 Tucson, Arizona 85704-3224.

7
8 Q. Did you submit direct testimony in this proceeding?

9
10 A. Yes. I filed direct testimony and direct rate design testimony on behalf of the
11 Southwest Energy Efficiency Project (SWEEP).

12
13 Q. Have there been any changes in your qualifications or representation of SWEEP?

14
15 A. No.

16 **Summary of SWEEP's Testimony in Partial Opposition to the Proposed Settlement**

17
18 Q. What is the purpose of your testimony?

19
20 A. In my testimony, I will:

- 21
- 22 ▪ Summarize how the proposed Settlement Agreement limits the Commission from
23 fully exploring the policy options for addressing utility financial disincentives to
24 energy efficiency, including limiting the Commission's consideration of full
25 revenue decoupling;
 - 26 ▪ Describe why full revenue decoupling, a mechanism the Commission adopted
27 one month ago in the Southwest Gas rate case after a thorough evaluation of all
28 of the evidence, is a superior option for the treatment of utility financial
29 disincentives to energy efficiency compared to the lost fixed cost revenue
30 recovery mechanism proposed in the Settlement Agreement;
 - 31 ▪ Recommend that the Commission substitute full revenue decoupling in place of
32 the lost fixed cost revenue recovery mechanism proposed in the Settlement
33 Agreement because full revenue decoupling more completely and effectively
34 reduces utility company disincentives for the support of activities that eliminate
35 energy waste, while lost fixed cost revenue recovery does not;
 - 36 ▪ Express why rate case moratoriums can limit the Commission's ability to direct
37 energy policy, and emphasize why caution should be exercised when enacting a
38 rate case moratorium, especially one as long as four years;
 - 39 ▪ Explain that performance incentives are an important policy instrument that the
40 Commission should exercise to influence and direct energy efficiency outcomes
41 during the energy efficiency implementation plan process;
 - 42 ▪ Provide recommendations on objectives and design criteria for an energy
43 efficiency performance incentive that establishes a clear connection between the

- 1 performance incentive level and the achievement of cost-effective energy
2 savings.
- 3 ■ Describe why and how energy efficiency, as a fundamental resource meeting the
4 real energy needs of customers at lowest cost, should be adequately funded in
5 base rates at stable levels; and
 - 6 ■ Explain how and why the impacts of Commission-adopted policies should be
7 reflected and accounted for in adjustments to test year sales used to set rates.

8 **Utility Financial Disincentives to Energy Efficiency and Preserving the**
9 **Commission's Ability to Consider Options and Decide Energy Policy**

- 10
11 Q. How does the proposed Settlement Agreement offer to address utility financial
12 disincentives to energy efficiency?
13
- 14 A. The Settlement Agreement proposes to implement a lost fixed cost revenue (LFCR)
15 recovery mechanism. This mechanism would recover a portion of the distribution and
16 transmission costs associated with the pursuit of energy efficiency and distributed
17 generation by residential, commercial, and industrial customers. The Settlement
18 Agreement would also allow residential customers to "opt out" of this LFCR
19 mechanism by accepting higher fixed charges through an increased basic service
20 charge.
21
- 22 Q. Does the proposed Settlement Agreement limit the Commission from fully
23 considering the policy options for addressing utility financial disincentives to energy
24 efficiency?
25
- 26 A. Yes. By offering only one option for addressing utility financial disincentives to
27 energy efficiency (i.e., the LFCR mechanism), the proposed Settlement Agreement
28 limits the Commission from fully exploring and vetting the various policy options it
29 could consider, including full revenue decoupling.
30

31 In contrast, the proposed Settlement Agreement offered in the Southwest Gas rate
32 case (and adopted by the Commission in December 2011), gave the Commission a
33 choice: it presented two clear policy options for Commission consideration – a LFCR
34 mechanism and a full revenue decoupling mechanism. As such, the Southwest Gas
35 Settlement Agreement provided a framework for the Commission to thoroughly vet
36 the policy and legal issues surrounding both full revenue decoupling and lost fixed
37 cost revenue recovery and to make a decision after a thorough deliberation of all of
38 the evidence.
39

- 40 Q. Does the Settlement Agreement address, in a positive and responsive manner, the
41 concerns raised by Commissioners during the Special Open Meeting on December
42 16, 2011, about settlement agreements limiting the Commission's ability to consider a
43 full range of options and decide energy policy?
44

1 A. No. As discussed above, the proposed Agreement does not offer a framework for the
2 Commission to thoroughly vet the policy and legal issues surrounding both lost fixed
3 cost revenue recovery and full revenue decoupling. Indeed, in any adoption of the full
4 Settlement as filed, the Commission would not be able to consider full revenue
5 decoupling at all. Instead, it would have to consider this option *entirely outside* of the
6 Agreement. Accordingly, the proposed Settlement limits the Commission's ability to
7 direct energy policy related to the treatment of utility financial disincentives to energy
8 efficiency and is therefore not responsive to the stated concerns by Commissioners at
9 the December meeting. Most notably, the proposed Settlement excludes from
10 Commission consideration full revenue decoupling — the very option that the
11 Commission approved for the Southwest Gas Company one month ago after a
12 thorough evaluation of evidence on both lost fixed cost revenue recovery and full
13 revenue decoupling.

14
15 Q. Why is full revenue decoupling a policy option worthy of Commission consideration?
16

17 A. As I testified in my direct testimony, the financial interest of the Arizona Public
18 Service Company ("Company" or "APS") should be better aligned with the interests
19 of its customers by reducing financial disincentives to utility support of energy
20 efficiency, thereby resulting in more energy savings, total lower costs for customers,
21 and larger customer energy bill reductions.

22
23 Full revenue decoupling completely and effectively reduces utility company
24 disincentives for the support of activities that eliminate energy waste. As such, full
25 revenue decoupling is important not only for full, enthusiastic utility support of
26 energy efficiency programs but also for activities that reduce sales but are not or may
27 not be directly linked to the Company's portfolio of energy efficiency programs. This
28 could include utility support for building energy codes; appliance standards; energy
29 education and marketing; state and local government energy conservation efforts; and
30 federal energy policies.

31
32 Q. Why is full revenue decoupling a superior option for the treatment of utility financial
33 disincentives to energy efficiency than the proposed LFCR mechanism?
34

35 The proposed LFCR mechanism inadequately reduces utility disincentives to energy
36 efficiency, and therefore results in fewer opportunities for customers to reduce their
37 energy bills. Consequently, it discourages Company support of building energy
38 codes, appliance efficiency standards, and state initiatives and legislation. It will also
39 likely result in contentious and protracted technical proceedings at the Commission
40 (as has been the experience in lost revenue recovery mechanism proceedings in other
41 states). Finally, the LFCR mechanism represents an automatic rate increase. In
42 contrast, because full revenue decoupling allows for rate adjustments in both a
43 positive and negative direction, decoupling could result in either a credit or a charge
44 on the customer bill.
45

1 LFCR does nothing to reduce APS' financial incentive to encourage customers to use
2 more electricity – and the more customers waste energy, the more APS revenues and
3 earnings increase. Also, under LFCR in the Agreement, as the Arizona economy
4 recovers and electric demand increases, APS revenues and earnings would also
5 increase. Specifically, APS could retain all revenues higher than the revenue levels
6 established by the Agreement, which would result in higher earnings. APS would also
7 retain all revenues higher than the revenue levels established by the Agreement from
8 increased electrification and electric vehicles. In contrast, full decoupling would
9 provide a credit to customers for any revenues higher than authorized revenues
10 (determined as authorized revenue per customer multiplied by the number of
11 customers).

12
13 Q. Does the proposed residential opt-out rate serve the interest of customers who want to
14 reduce their energy bills?

15
16 A. No. The residential opt-out rate requires customers to accept higher fixed charges
17 through an increased basic service charge. As I testified in my rate design direct
18 testimony, SWEEP does not support increasing the basic service charge as a
19 mechanism to recover additional fixed costs. Increasing the basic service charge
20 mutes the price signal to customers by reducing the amount of utility bill cost savings
21 that customers experience when they conserve energy or increase their energy
22 efficiency.

23
24 Q. What action should the Commission take on the Settlement Agreement?

25
26 A. The Commission should approve the Settlement Agreement with the exception of
27 Section IX (see additional comments of other portions of Section IX, below). In its
28 stead, the Commission should substitute the Company's original decoupling proposal.

29 **Rate Case Moratorium/Stay-Out Provision and Preserving the Commission's**
30 **Ability to Decide Energy Policy and Respond to Changing Conditions**

31
32 Q. Does the Settlement Agreement propose a rate case moratorium?

33
34 A. Yes. The proposed Settlement Agreement includes a four-year rate case stay-out
35 provision that, if adopted, would prohibit the Company from filing a new general rate
36 case application until July 1, 2016.

37
38 Q. Do rate case moratoriums limit the Commission's ability to direct and determine
39 energy policy?

40
41 A. Rate case moratoriums effectively freeze rates for a specified period of time, despite
42 shifts in the economy or energy/regulatory policies that might otherwise call for a
43 reexamination of and possible change to rates. In turn, rate case moratoriums can
44 limit the Commission's ability to direct energy policy, especially those policies that
45 come about or evolve after establishment of the moratorium in question.

1
2 Q. Are there any recent examples to illustrate this point?
3

4 Yes. The Settlement Agreement adopted in Tucson Electric Power Company's (TEP)
5 2008 rate case included a stay-out provision that prohibits the Company from filing a
6 new general rate case application until mid-2012. As the Commission is fully aware,
7 this stay-out provision has constrained Commission options and actions related to the
8 achievement of the Electric Energy Efficiency Standard (adopted in 2010) and the
9 Commission's review of the TEP EE Implementation Plan, and may prevent or limit
10 TEP customers from receiving the full value of energy efficiency investments (i.e.,
11 reducing their utility bills and lowering total costs for customers).
12

13 Q. Are rate case moratoriums a good idea during uncertain economic times?
14

15 A. During uncertain economic times, a rate case moratorium may offer stability to
16 customers in the form of a rate freeze. Alternatively, it may subject customers to
17 higher than necessary rates and costs or to higher future costs. And, when combined
18 with the LFCR mechanism in the Agreement (rather than full decoupling), it results in
19 APS retaining all of the revenues that are higher than the revenue levels established
20 by the Agreement rather than providing credits to customers, for the full period of the
21 stay-out provision. For these reasons, SWEEP believes the Commission should
22 exercise caution when enacting a moratorium, especially one as long as four years (as
23 proposed in this Settlement Agreement).
24

25 Q. What action should the Commission take to mitigate the negative effects of the long
26 stay-out provision?
27

28 A. If the Commission chooses to adopt the proposed Agreement, SWEEP recommends
29 shortening the stay-out period to three years. At the very least, SWEEP recommends
30 that in three years time or sooner the Commission exercise its authority to initiate a
31 systematic review to determine if rates are just and reasonable for customers and to
32 determine whether the continuation of the stay-out provision is warranted.

33 Energy Efficiency Performance Incentive 34

35 Q. What does the Settlement propose for an energy efficiency performance incentive?
36

37 A. If adopted, the Settlement Agreement would slightly modify the Company's current
38 performance incentive by removing and changing certain performance tiers. It would
39 also initiate a stakeholder process for the development of a new performance
40 incentive by December 31, 2012, for Commission consideration and possible
41 implementation at a later date.¹
42

¹ See Sections 9.14b and 9.14d of the proposed Settlement Agreement.

1 Q. Does the Electric Energy Efficiency Standard provide guidance for when a
2 performance incentive may be adopted?
3

4 A. Yes. The Electric Energy Efficiency Standard states that, "In the implementation
5 plans required by R14-2-2405, an affected utility may propose for Commission
6 review a performance incentive to assist in achieving the energy efficiency standard
7 set forth in R14-2-2404. The Commission may also consider performance incentives
8 in a general rate case" (R14-2-2411). In other words, the Electric Energy Efficiency
9 Standard allows for performance incentives to be proposed and adopted during a rate
10 case or during the annual energy efficiency implementation plan process.
11

12 Q. Does SWEEP have a preference on when performance incentives should be proposed
13 and adopted?
14

15 A. Yes. SWEEP views performance incentives as an important policy instrument that the
16 Commission should exercise to influence and direct energy efficiency programs and
17 outcomes for the benefit of customers. To that end, we believe it is critical for the
18 Commission to be able to oversee and modify performance incentive design during
19 the energy efficiency implementation plan process, when new energy efficiency
20 programs and initiatives are proposed, reviewed, and approved by the Commission,
21 and when energy efficiency policy is implemented.
22

23 Q. What is your view of the timing of the process for the development of a new
24 performance incentive, as set forth in the Settlement Agreement Section 9.14d?
25

26 A. Consistent with the arguments above, SWEEP believes the new performance
27 incentive should be developed by mid-2012, filed by APS as part of its 2013 Demand
28 Side Management (DSM) Implementation Plan, and considered by the Commission
29 as part of its review of the 2013 DSM Implementation Plan. There is no reason for
30 APS, Staff, and stakeholders to wait until December 2012 to complete the
31 development of a new performance incentive that will better incent achievement of
32 cost-effective energy savings.
33

34 Q. But mid-2012 is likely earlier timing than a final decision in this proceeding, correct?
35

36 A. Yes. For this reason SWEEP recommends that APS initiate a process now to work
37 with Staff and other stakeholders to develop a new performance incentive for
38 Commission consideration as part of the 2013 DSM Implementation Plan process.
39

40 Q. Does SWEEP have any recommendations with respect to the performance incentive,
41 if the Commission were to adopt the proposed Settlement Agreement with the
42 performance incentive process and timing as set forth in the Settlement Agreement?
43

44 A. Yes. If the Commission adopts the proposed Settlement Agreement, thereby delaying
45 the consideration of a new performance incentive until December 2012 at the earliest,
46 the Commission should make known its objectives for performance incentive design,

1 and these objectives should be set forth in the Commission's final decision. In
2 SWEEP's view an appropriately designed performance incentive would meet the
3 following objectives:

- 4 1. It encourages the Company to pursue cost-effective energy efficiency;
- 5 2. It is designed in such a way to avoid any perverse incentives;
- 6 3. It is based on clearly-defined goals and activities that are sufficiently
7 monitored, quantified, and verified;
- 8 4. It is available only for activities for which the Company plays a distinct and
9 clear role in bringing about the desired outcome; and
- 10 5. It is kept as low as possible while balancing and meeting the objectives and
11 principles mentioned above.

12 Q. Does SWEEP have any additional recommendations on specific design criteria for the
13 performance incentive, which the Commission should require in its final decision?

14 A. Yes. If the Commission adopts the proposed Settlement Agreement with the process
15 to develop a new performance incentive, the Commission should also require the
16 following design criteria for the new performance incentive:

- 17 1. Encourage the achievement of energy savings and net benefits for customers
18 through a performance incentive with an eligible incentive level equivalent to 7%
19 of net benefits on a pre-tax basis;
- 20 2. Include new components and metrics that emphasize increased
21 comprehensiveness of energy efficiency program services provided to customers
22 and result in higher percent savings, encourage cost-efficiency in the use of
23 ratepayer funds (i.e., total net benefits to customers per dollar of ratepayer
24 funding provided), and target the achievement of specific performance goals such
25 as serving a targeted number of low income customers and/or issuing a specific
26 targeted number of residential loans or a targeted total loan amount; and,
- 27 3. Have an absolute dollar cap on the total incentive amount that the Company may
28 earn, set at 115% of the eligible incentive level (determined at 100% of target
29 performance), thereby not incenting increased program spending through the
30 design of the performance incentive mechanism or its incentive cap.

1 primary resource to meet energy growth over the next decade. In fact, from 2011 to
2 2020, energy efficiency will meet more than half of APS' planned energy growth,
3 making it the Company's largest growing energy resource for meeting load growth
4 over the next ten years. For these reasons, energy efficiency must be satisfactorily
5 funded and provided funding stability – else the numerous public interest benefits of
6 this core resource may not be realized. Stability in policies and funding is a key to
7 maximizing the customer benefits from energy efficiency.

8 **Accounting for Commission-Adopted Policies as an Adjustment to Sales**
9

10 Q. Are there other rate-making issues in this case that the Commission should consider,
11 as part of a package of improved practices in utility regulation and ratemaking in an
12 era of focusing on reducing customer energy bills through increased energy
13 efficiency?
14

15 A. Yes. The current system for ratemaking does not fully account for Commission-
16 adopted policies. In particular, it does not account at all for the Electric Energy
17 Efficiency Standard or its impacts. Indeed, the test year sales based on an historic test
18 year and used to set rates in this proceeding ignore the energy savings required by the
19 Standard that will be experienced in the years for which the new rates are effective.
20

21 Q. Why is it important to account for Commission-adopted policies when setting rates?
22

23 A. If the rate setting process does not account for Commission-adopted policies, a
24 disconnect arises between ratemaking and the very policies themselves. This
25 disconnect can lead to regulatory lag, mismatches between cost causation and cost
26 recovery, and the under-recovery of authorized fixed costs. The Commission should
27 approve rates that are adequate in recovering Commission-authorized costs within the
28 same time period in a manner that is consistent with the effects of Commission-
29 adopted policies.
30

31 Q. How can the Commission remedy this issue?
32

33 A. The impacts of Commission-adopted policies should be reflected and accounted for in
34 the test year sales used to set rates. As I testified in my direct rate design testimony, a
35 post-test year adjustment to sales (which would impact revenues) should be applied to
36 test year sales, to account for the energy savings and load-reducing effects of the
37 Commission-adopted Electric Energy Efficiency Standard requirements. The Electric
38 Energy Efficiency Standard requirements and their impacts on sales are known and
39 measurable. Further, applying the post-test year adjustment would result in better and
40 more accurate alignment of revenues and expenses based on these known and
41 measurable quantities. If the Commission is concerned whether a full 100% of the
42 Electric Energy Efficiency Standard requirement would be met in each and every
43 year, the post-test year adjustment could be applied at a level of 75% of the Electric
44 Energy Efficiency Standard requirement.
45

Conclusion

1
2
3
4
5
6

Q. Does this conclude your testimony?

A. Yes.