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BEFORE THE ARIZONA CORPORATION COMMISSION

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 **FREEPORT-MCMORAN COPPER & GOLD INC. AND ARIZONANS FOR ELECTRIC CHOICE AND COMPETITION'S COMMENTS ON STAFF'S REPORT AND PROPOSED AMENDMENTS REGARDING TUCSON ELECTRIC POWER COMPANY'S PROPOSED MODIFIED ENERGY EFFICIENCY PLAN**

Freeport-McMoRan Copper & Gold Inc. ("Freeport-McMoRan") and Arizonans for Electric Choice and Competition (AECC) (collectively "AECC") hereby submits this Response to Staff Report ("Report") dated February 28, 2012, concerning Tucson Electric Power Company's 2011-2012 Energy Efficiency Implementation Plan.

INTRODUCTION

In its Report, Staff provides the following three recommendations: (i) update the Demand-side Management Surcharge ("DSMS") and establish a deferral account to track lost fixed costs arising from Tucson Electric Power Company's ("TEP") energy efficiency programs; (ii) provide a conditional waiver and reset the DSMS to reflect the lower spending levels, and (iii) adopt TEP's Proposed Modified Implementation Plan ("Modified Plan"), with an amendment that would eliminate the 4.19% charge for non-residential customers and require the DSMS to be charged on a per-kWh basis.

AECC asserts that all three Staff proposals should be rejected for the reasons set forth below. In its Comments filed on February 14, 2012, AECC indicated its support for the structural changes in the Modified EE Plan, but expressed AECC's concerns about the overall cost to customers. To the extent that the Arizona Corporation Commission ("Commission") entertains changes to the Modified EE Plan, AECC recommends that those changes focus on the overall cost of the Modified EE Plan to customers, as well as incorporating the exemption/waiver provisions described below. With respect to the latter, AECC requests Freeport-McMoRan be granted an exemption/waiver from A.A.C. R14-2-2408(E), pursuant to A.A.C. R14-2-2419(A), which request is being filed concurrent with this Response, and attached hereto as Exhibit 1.

DISCUSSION

I. Staff's Alternative Proposal No. 1 Is More Costly to Customers than the Modified EE Plan and Should Be Rejected Because It Is Too Expensive.

As noted in TEP's Reply to Staff's Update, Staff's Alternative Plan would result in higher rates to customers than the Modified EE Plan. If the Commission's EE objectives can be met with a less costly plan, then it is plainly in the public interest to pursue the less expensive course of action.

II. Staff's Alternative Proposal No. 1 Violates the 2008 Settlement Agreement, and is Contrary to Arizona Law.

A. *Establishing a Deferral Account to Track Lost-Fixed Costs Related to Revenues Violates the 2008 Settlement Agreement Approved in Decision No. 70628, dated December 1, 2008.*

In its original proposal, TEP sought to recover approximately $16.8 million in lost-fixed cost revenue through the establishment of an Authorized Revenue Requirement True-Up ("ARRT"). AECC has been steadfast in its assertion that approval of the ARRT would violate Arizona law by implementing a rate increase outside of a rate case. It appears that Staff's solution to this legal hurdle is to establish a deferral account to track TEP's lost-fixed costs related to lost revenue resulting from implementation of energy efficiency programs for consideration in the company's next rate case.

However, Section 10.1 of the 2008 Settlement Agreement ("Settlement") requires that TEP's base rates remain frozen through December 31, 2012.[1] Allowing TEP to track its lost-fixed costs related to lost revenue during a period when its base rates are to remain frozen – so that they can be recovered in a future rate case – means that a rate increase which could have occurred, absent the Settlement, is being delayed for future customers. It does not matter that Staff's proposed deferral of lost-fixed costs related to lost revenues does not guarantee future rate relief; the mere possibility that it <u>*can*</u> be an issue in the next rate proceeding is enough to cause concern, since TEP's revenue requirement and base rates were already resolved by the Settlement. Therefore, Staff's proposed solution to changing base rates outside a rate case by the establishment of a deferral account is not a valid solution because the operative effect of the accounting would be to determine what rates *would have been* had TEP's rates not been frozen through December 31, 2012. Furthermore, allowing recovery would violate the prohibition against retroactive rate-making in Arizona.

B. *The Recovery of Lost-Fixed Revenue in a Future Rate Case Involves Retro-Active Ratemaking and Would Violate Arizona Law.*

At its core, Staff's proposal to create a deferral account allowing TEP to defer lost-fixed costs related to lost revenues associated with the Energy Efficiency Standards "for consideration in [TEP's] next rate case" would violate the stay out provision of the 2008 Settlement Agreement by allowing TEP to file a rate case retroactively covering the stay out period through the subterfuge of deferral accounting and retroactive

[1] Non-recovery of lost-fixed costs related to lost revenue does not constitute an 'emergency' under the Settlement because the solution is quite simple – the granting of a waiver from the 2012 Energy Efficiency Standard and set the DSMS to levels that preclude TEP from claiming lost revenues.

ratemaking. Not only does that concept violate the 2008 Settlement Agreement by allowing TEP to recover lost revenue from the stay out period, such proposal involves retroactive ratemaking in violation of fundamental Arizona utility law.

Retroactive ratemaking occurs when the Commission requires refunds of an established, approved rate that is final. *Arizona Cons. Council v. Corp. Comm'n,* 200 Ariz. 905, 911, 22 P.3d 905, 911 (App. 2001); *Pueblo Del Sol Water Co. v. Arizona Corp. Comm'n*, 160 Ariz. 285, 287, 722 P.2d 1138, 1140 (App. 1988). Retroactive ratemaking also occurs when the Commission allows a utility to apply a rate increase retroactively to recover costs, expenses or lost revenues incurred in years prior to the rate case test year. As a matter of fundamental utility law, "[w]hen an agency approves a rate, and the rate becomes final, the agency may not later on its own initiative or as the result of a collateral attack make a retroactive determination of a different rate and require reparations." *Mountain States Telephone and Telegraph Co. v. Ariz. Corp. Comm'n, 124 Ariz. 433, 436, 604 P.2d 1144, 1147 (App. 1979), citing Arizona Grocery Co. v. Atchison, T. & S.F. Railroad Co.*, 284 U.S. 370 (1932).

Both the Commission and Staff have recognized and followed the prohibition against retroactive rate making in various other cases. *See* Decision No. 72897, *Goodman Water Company*, at 15 (February 21, 2012) ["In addition, Staff also believes that the deferral of accumulated depreciation and depreciation expense raises the specter of retroactive ratemaking, which occurs when future rates permit a utility to recoup past losses or refund excessive past income."]; Decision No. 71854, *Johnson Utilities* at 57 (August 24, 2010) ["Staff stated that to require the Company to refund its customers from 2007 forward, as recommended by Swing First, raises issues of retroactive ratemaking, and that generally, the rule against retroactive ratemaking prohibits the retroactive adjustment of rates to account for unexpected expenses or revenues."]; Decision No. 71902, *Payson Water Company* at 10 (September 28, 2010) [refusing to apply water augmentation surcharge retroactively because "Staff's accounting witness believe[d] that the Company's proposal to make the water augmentation surcharge effective retroactively to May 1, 2010, would constitute retroactive rate making in violation of Arizona law."].

On these issues, Staff cannot rely on the argument that its proposal is an accounting order and does not involve any ratemaking treatment of TEP's rates. That argument fails because the primary reason for TEP to keep track of its lost-fixed costs related to lost revenues associated with the Energy Efficiency Regulations is to seek recovery of those lost-fixed costs related to lost revenues in its next rate case. The express purpose of the accounting order would be to affect and recoup TEP's past revenue losses resulting from the Energy Efficiency Regulations. As the Commission recognized in Decision No. 72897, "[t]he Commission has the power to change its accounting treatment for specific items, but to avoid running afoul of retroactive ratemaking, such changes should not affect past losses or gains." Decision No. 729897 at 10. Here, Staff's proposal runs afoul of the prohibition against retroactive ratemaking by creating a deferral account for TEP's past revenue losses. Approval of an accounting order that allows TEP to track lost revenue from energy efficiency requirements for inclusion in a future rate increase, by definition, involves potentially adjusting future rates to compensate for TEP's past losses.

Staff's proposal can only lead to a textbook example of retroactive ratemaking and should be rejected. Put simply, allowing TEP to defer lost revenues from the Energy Efficiency Rules for retroactive recovery in a future rate case would violate sound regulatory principles that preclude retroactive adjustments to established rates and would conflict with rulings in *Scates v. Arizona Corporation Comm'n*, 118 Ariz. 531, 578 P.2d 612 (Ariz. App. 1978) prohibiting piecemeal ratemaking and with Arizona's constitutional provisions regarding ratemaking. Even further, Staff's proposal also raises the specter of inter-generational inequities by creating the possibility of imposing increased rates on future TEP customers to compensate TEP for revenue losses from services provided to prior customers.

Additionally, in the event the Commission chooses to allow TEP to defer lost-fixed costs related to lost revenue for recovery in a future rate case, AECC members who pay demand charges should be exempt from such recovery as they continue to pay TEP for fixed costs through the demand charge component of their electricity bills.

III. Staff's Alternative Proposal No. 2 is Flawed

Staff's Alternative Proposal No. 2 has one redeeming quality: it imposes a smaller rate increase on customers than other options being considered. AECC supports a smaller rate increase, but within the framework of the Modified EE Plan, including an equal percentage rate for all non-residential customers. Although a waiver from the 2012 Energy Efficiency Standard would address TEP's immediate issues for compliance, keeping the cumulative requirement through 2020 would force TEP to make up any shortfall through ever-larger rate increases on its customers. Requiring TEP to essentially "catch up" in subsequent years means that large increases in the DSMS are likely. If spending levels are to remain at 2010 levels, then the cumulative requirements should also be modified for TEP to reflect that level of funding.

IV. Staff's Alternative Proposal No. 3 to Adopt TEP's Proposed Modified Implementation Plan, and the Proposed Amendment Thereto, Does Not Serve the Public Interest.

Staff seeks to eliminate the equal percentage charge for non-residential customers that was negotiated by TEP, AECC, RUCO, and SWEEP and impose a per-kWh rate design. Staff claims that it objects to an equal percentage rate because the "percentage increase" that results from an equal percentage rate is different among various classes within the non-residential sector, and is thereby "inequitable." AECC strongly disagrees. On its face, Staff's argument that an equal percentage rate causes disparate percentage impacts is absurd. It is a plain fact that an equal percentage rate affects all customers equally in percentage terms. This fact is self-evident and transparent. Staff's calculation of disparate impacts starts with its preferred per-kWh rate – which results in a higher percentage impact on larger customers – and then calculates the rate impact on different customer groups of moving to an equal percentage rate from this unfair starting point. All Staff's analysis shows is that if one starts with a rate that disadvantages larger customers (through a larger percentage increase) and favors smaller customers (through smaller percentage increases), then correcting this disparity by moving to an equal percentage rate for all will reduce the rate for the former and increase it for the latter – relative to the unfair starting point. This is mere common sense. Staff turns this common sense on its head by focusing on the percentage impact of fixing the disparity rather than the percentage impact of the final result. Staff is only correct in that equity is at issue here; however, equitable treatment calls for an equal percentage burden for all non-residential customers. Staff's proposed amendment disregards the rate design compromise negotiated by stakeholders and ignores the disproportionate negative impact on larger customers from a per-kWh charge. Staff's proposed Amendment No. 4 should be rejected.

Rather than adopting the proposed Amendment No. 4, AECC submits that the public interest would be better served by reducing the overall costs of the Modified EE Plan. One means is to extend the period for recovering the $5.6 million in un-recovered program costs from prior periods from 22 months to 46 months. This modification would reduce annual charges to customers in the upcoming 22-month period by about $1.4 million per year. And while such a modification would bring the overall costs down to 3%, it would mitigate the impact to customers. Although not perfect, TEP's Proposed Modified Implementation Plan is an improvement over its original filing, and one that AECC can support subject to its recommendation for further reductions, and without Staff's Proposed Amendment No. 4.

V. <u>The Commission Should Grant Freeport-McMoRan's Request for an Exemption from A.A.C. R14-2-2408(E).</u>

As set forth in the request attached hereto as <u>Exhibit 1</u>, there is good cause for granting Freeport-McMoRan a waiver from the provisions of A.A.C R14-2-2408(E). Freeport-McMoRan already employs energy efficiency programs that benefit all of TEP's ratepayers by reducing the overall consumption of electricity, which in turn leads to a reduction of fuel costs, purchased power costs, new capacity costs, transmission costs and distribution costs, as well as reducing adverse environmental impacts (such as water consumption and air emissions) associated with new facilities.

CONCLUSION

AECC recommends rejection of the Staff alternative proposals to the Modified EE Plan, which AECC believes is the plan most likely to avoid further litigation. As previously set forth in AECC's February 14, 2012 comments to TEP's Proposed Modified Implementation Plan for 2012-2013, AECC supports the structural changes contained therein, but remains concerned about the overall increase in cost to customers at approximately 4%. Instead, AECC continues to encourage the Commission to reduce the overall cost of the Modified EE Plan to closer to 3%, which is more consistent with how other states allow utilities to recover for energy efficiency programs. See Table 2, AECC Comments (September 26, 2011). Moreover, there is good cause for granting Freeport-McMoRan a waiver from the provisions of A.A.C R14-2-2408(E).

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RESPECTFULLY SUBMITTED this 9th day of March 2012.

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EXHIBIT 1

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BEFORE THE ARIZONA CORPORATION COMMISSION

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 **REQUEST FOR EXEMPTION FROM A.A.C. R14-2-2408(E)**

Freeport-McMoRan Copper & Gold, Inc. ("Freeport-McMoRan" or "Company") hereby submits this Request for Exemption from A.A.C. R14-2-2408(E) with respect to Tucson Electric Power Company's 2011-2012 Energy Efficiency Implementation Plan, pursuant to A.A.C. R14-2-2419(A).

INTRODUCTION

Freeport-McMoRan is the world's largest publicly traded copper company, with several mining operations employing approximately 8,000 persons in Arizona. The Company has been active in sustainable development efforts, which is the foundation on which Freeport-McMoRan operates. As a large multi-national entity, one of the Company's fundamental challenges is to find the most efficient production methods that will enable it to meet demand for products in a cost-effective manner while minimizing negative impacts. Energy efficiency is central to this theme, and vital to Freeport-McMoran in managing electricity costs in order to stay competitive in the marketplace. The Company budgets at least $10 million annually on energy-related technology. As a result, Freeport-McMoRan has developed several initiatives in order to address the efficient use of electricity during all stages of its mining operations.

The Company runs a Technology Center that staffs over 300 professionals, with offices and laboratories in Safford, Morenci and Tucson. The three major disciplines at the Technology Center include improving mining, processing and environmental technologies in order to improve operating efficiencies. For instance:

- as an energy-conserving alternative to smelting, concentrated leaching is useful where allowed by mineral type and market demand.
- The Company is also developing a full scale electrowinning technology (at the Morenci location) that can reduce the electricity used for this type of processing by 50%.
- In reducing ore variances, power can be minimized for crushing and grinding purposes.
- The Company was the first in its industry to utilize the most energy efficient communition facilities.
- Copper and molybdenum pressure oxidization techniques can reduce power consumption in the smelting process by between 29-36%.
- Freeport-McMoRan is developing technology for producing electrowon cathodes and copper with 15% less energy.

Clearly, TEP cannot implement an energy efficiency program for Freeport-McMoRan that is more cost effective than what has been, or will be, spent internally to reduce power consumption. In short, the margin for increasing energy efficiency savings beyond the Company's efforts and current electric load is miniscule, if available at all. The free market and competition force companies in power-intensive industries such as mining to become more efficient, which in turn benefits TEP's other ratepayers due to the reduction in fuel costs, purchased power costs, new capacity costs, transmission costs and distribution costs. In addition, there are reduced adverse environmental impacts (such as water consumption and air emissions) associated with reducing the need for new facilities to serve growth.

As an additional benefit to TEP and its ratepayers, removing Freeport-McMoRan's electric load (and the kilowatt-hour sales associated with the load) from TEP's cumulative annual energy savings calculation will improve the percentage savings on an annual basis through 2020. In turn, the Company can use the funds – that would otherwise go to pay the existing Demand Side Management Surcharge – in a more efficient and effective manner that achieves concrete, sizeable reductions in energy consumption within TEP's service territory.

RELIEF REQUESTED

A.A.C. R14-2-2408(E) states that "All customer classes of an affected utility shall bear the costs of DSM programs by payment through a non-bypassable mechanism, unless a customer or customer class is specially exempted by Commission order." A.A.C. R14-2-2419(A) allows the Commission to "waive compliance with any provision of this Article for good cause." Based on the arguments contained herein, Freeport-McMoRan requests that the Commission grant the Company an exemption from the funding requirements set forth in A.A.C. R14-2-2408(E) in this proceeding, for good cause shown, pursuant to the authority set forth in A.A.C. R14-2-2419(A).

If the Commission wishes to expand the exemption to a customer class rather than just Freeport-McMoRan specifically, then the Company suggests that in order to qualify for the exemption, the retail customer must spend at least $10 million annually on company-wide energy related programs, and take service at a voltage threshold of 46kV or above.

RESPECTFULLY SUBMITTED this 9th day of March 2012.

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