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Tucson Electric Power Company

**88 East Broadway Blvd., Post Office Box 711
Tucson, Arizona 85702**

April 13, 2012

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Re: Notice of Filing – Tucson Electric Power Company’s 2012 Cost Containment Report
Decision No. 71256, Docket Nos. E-01933A-05-0650, E-01933A-07-0402

Pursuant to Decision No. 71256 (September 3, 2009), Tucson Electric Power Company hereby files its annual 2012 Cost Containment Report as required by Decision No. 59594 (March 29, 1996).

If you have questions or comments please contact me at (520) 884-3680.

Best regards,

Jessica Bryne
Regulatory Services

Enclosures: Cost Containment Report

cc: Mr. Ernest Johnson, Executive Director, ACC
Mr. Steve Olea, Utilities Division Director, ACC
Phil Dion, Vice President, TEP

Arizona Corporation Commission
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COST CONTAINMENT REPORT

The following is a summary of Tucson Electric Power Company's ("TEP" or "Company") cost containment efforts and quantified savings for the year 2011. For a detailed table outlining TEP's total savings for 2011 of \$20.6 million please refer to the attached Exhibit A.

▪ **Employee and Other Compensation Costs** (Exhibit A – Yellow Cells)

TEP instituted company-wide hiring restrictions for 2009 and continued an approval process through 2011. This process saved TEP approximately \$3.6 million compared to budget. TEP also made changes to its pension retirement and death benefits plans, while eliminating the early retirement "Rule of 85" plan for employees hired after June 1, 2009. These and other pension changes resulted in continued savings of \$235,000. Additionally, TEP saved \$695,000 on life insurance premiums for employees by switching vendors for a total savings on employee-related costs of \$4.5 million in 2011.

▪ **Contract Renegotiation / Supply Chain Management** (Exhibit A – Green Cells)

The Company implemented a supply chain sourcing effort in 2009 that continues to reduce costs for gasoline, equipment, poles, wires, transformers and hydrogen and saved \$3.1 million in 2011. Additionally, the Company renegotiated a contract for telephone fees and reduced usage of services amounting to a savings of \$87,000. Good relationship building with contractors and negotiations with insurance carriers has also resulted in a savings of \$403,000. These efforts resulted in a total savings of \$3.6 million for 2011.

▪ **Generation Expenses** (Exhibit A – Gray Cells)

TEP's coal-fired generation plants underwent various changes beginning in 2009. Some of those changes produced one-time savings, while others created permanent, ongoing savings. Ongoing savings were achieved at TEP's Springerville Generating Station ("SGS") due to the addition of Tristate's SGS Unit 3 in 2006 and SRP's SGS Unit 4 in 2009. These units have reduced TEP's expenses by \$7.5 million because of: (1) shared facilities between the companies; (2) reductions in property tax expenses; and (3) sharing operations, maintenance and overhead costs.

▪ **Technology Services** (Exhibit A – Blue Cells)

TEP saved \$1.4 million in 2011 by continuing to improve its technology services. The Company saved an additional \$352,000 by increasing the use of electronic customer bills and automated bill pay and saving costs on the related postage and bill stock costs. Automating outbound calls reduced the need for contract employees, and through implementation of the virtual hold program in our Call Center, TEP saved \$142,000 in long distance call charges. TEP has also invested in Meter Data Management implementation which has resulted in a savings of \$230,000 in reduced manual reads. The optimized use of hardware has also resulted in savings of \$716,000.

- **Administrative Support Savings** (Exhibit A – Red Cells)

Numerous initiatives were undertaken within administrative areas to achieve a total savings of \$1.3 million. Examples of those initiatives include the following: (1) eliminating the printing of the annual report; (2) revising the customer bankruptcy process which reduced legal fees and write-off costs; (3) hiring two attorneys thereby reducing outside legal counsel fees; (4) instituting other initiatives within Customer Service; and (5) process improvements made in Accounts Payable, Payroll and Accounting which consolidated services and reduced costs.

- **Discretionary and Revenue Enhancements** (Exhibit A – Orange Cells)

Discretionary and revenue enhancements totaling \$2.2 million include: (1) minimizing travel and training expenses company-wide in 2011 to achieve a savings of \$1.2 million compared to budget; (2) selling two transformers to eliminate future O&M costs - \$97,000; (3) eliminating the annual standby capacity payment made to large commercial customer - \$144,000; (4) service agreement for resource planning - \$96,000; (5) negotiating with the county to replace load with TEP service, previously using their own generators - \$205,000; and (6) performing an evaluation on discount program and finding customers who no longer qualified for the program amounting to an additional \$442,000 in revenue.

EXHIBIT A

Exhibit A

Area		Initiative		Explanation of Initiative		Estimated Savings
Cost Reductions						
Generation Expenses	SGS 3 & 4 Synergies	The addition of SGS Units 3 & 4 has reduced TEP's expenses by \$6.5M due to: shared facilities between companies; reductions in property taxes; and shared operations, maintenance and overhead costs.				\$7.5M
Employee and Other Compensation	Hiring Restrictions	Hiring restrictions requiring Sr. VP approval for any new hires				\$3.6M
Discretionary Expenses	Travel & Training	Economic conditions forced reductions in many areas; this amount represents the dollars unspent (given up) by departments company-wide for 2011.				\$1.2M
Technology Services	IT Virtualization	Optimize use of hardware. IT Productivity Gains - Server Provisioning, Avoided Maintenance, Server and Storage Refresh Cost Avoidance, Virtual Server Cost Avoidance				\$716K
Employee and Other Compensation	Changes in employee benefits related to life insurance	Changed vendor providing life insurance to employees thereby saving \$600K annually beginning in 2010.				\$695K
Technology Services	E-Bill	Savings in mail services due to volume changes and use of E-bill. Savings seen in postage, envelopes, and bill stock. Also less use of paper from internal customers. More use of soft copy instead of hard copy.				\$352K
Adm Support Savings	AP & Payroll process improvements	Process improvements made in AP and Payroll allowed consolidation of some SGS activities in both departments which saves approx. 2 FTE's.				\$331K
Adm Support Savings	Legal Fees	In 2011, we hired an attorney and intern to begin handling matters that had been completed utilizing outside legal firms.				\$260K
Technology Services	Decrease in Meter Reads	MDM implementation reduced the number of meters that are manually read each month.				\$230K
Adm Support Savings	High/Low Billing Exceptions Review	Changed the high/low billing exceptions parameter resulting in fewer exceptions requiring review.				\$228K
Adm Support Savings	Audit Payments	Audit payments to vendors to identify and recover any overpayments				\$183K
Employee and Other Compensation	Changes in employee benefits related to pension expense	Eliminated pension retirement for employees on disability, eliminated lump sum distribution death benefit, and eliminated the Rule of 85 for employees hired as of June 1, 2009.				\$170K
Technology Services	Virtual Hold and IVR/ACD Implementation	Savings on long-distance calls. Customers calling in on 800 number can leave a number and a customer service representative will return their call rather than have them waiting on hold. Automated outbound calls and eliminated contract employees				\$142K
Adm Support Savings	Annual Report Elimination	Eliminated printing the annual report				\$100K
Adm Support Savings	Collection letter at Day 75	Reinstated sending customers a collection letter on day 75 warning of sending their account to a collection agency on day 95 resulting in \$.3M in collections not needing to pay a 21% agency fee.				\$69K
Adm Support Savings	Bankruptcy Processing	Revised process reducing legal fees and write-off losses				\$62K
Employee and Other Compensation	Decrease OSHA incident rate	Continued efforts to reduce safety incident rates translates into Workman Compensation cost savings.				\$57K
Adm Support Savings	Web Automation	Automated some of the start/stop/transfer service requests from the internet to CC&B to eliminate manual handling of the request by a customer service representative.				\$46K
Contract Renegotiation / Supply Chain Mgmt	Fuel discount	TEP supplies fuel for contractor equipment and saves the difference between contractor's fuel costs and TEP's bulk fuel costs.				\$36K
Adm Support Savings	After hours answering	After hours answering service taken in-house eliminating the outside services fee, reducing overtime for field staff by better evaluation of the issue from internal staff, and more productivity handling call center administrative work.				\$30K
Employee and Other Compensation	Zero copy for generic brand	If employees used Express Scripts, we instituted a zero copy program if employees would use the generic brand. In place for six months in 2011.				\$8K
Adm Support Savings	Direct Deposit	Eliminate delivery of pay deposit confirmation and encourage direct deposit over negotiable paychecks (mail checks to home and not overnight mail to work).				\$6K

Exhibit A

Area		Initiative		Explanation of Initiative		Estimated Savings
Contract Renegotiation						
Contract Renegotiation / Supply Chain Mgmt	Savings through Bidding Process (Capital and O&M)	A "Documented Calculated Savings" formula is used by the Procurement & Contracts department to estimate the dollars saved when the competitive bidding process is used to purchase goods and/or services.				\$2,822K
Contract Renegotiation / Supply Chain Mgmt	SGS Property Insurance	Negotiated return cash premium for SGS appraisal prior to renewal.				\$280K
Contract Renegotiation / Supply Chain Mgmt	Payment terms	Met with various suppliers to make changes to payment terms				\$160K
Contract Renegotiation / Supply Chain Mgmt	Employment Practice Liability	Negotiated insurance claim recovery for Employment Practice Liability (EPL) claim previously denied by insurer, AEGIS.				\$157K
Contract Renegotiation / Supply Chain Mgmt	Communication Fees	Renegotiated fees and reduced usage of service.				\$87K
Contract Renegotiation / Supply Chain Mgmt	Property Insurance	Six months prior to renewal leveraged a soft Property insurance market into a flat rate. Approximate savings of 5% on \$3M, or \$150K, of which 4 months were realized in 2011.				\$50K

Revenue Enhancement						
Revenue Enhancements	Discount Programs	Evaluate Customer Discount Programs				\$442K
Revenue Enhancements	Load Replacement	Negotiated with government entity to take several of their generators off-line and replaced load with TEP service.				\$205K
Revenue Enhancements	Stand by Capacity	Negotiated large customer contract for the next five years to terminate the annual \$144,000.00 (12k monthly) standby capacity payment. Elimination began December, 2010				\$144K
Revenue Enhancements	Sale of Transformers	Sold two (2) 2500 kVa transformers to large commercial customer eliminating future O & M costs for these two points of delivery.				\$97K
Revenue Enhancements	Resource Planning	Service Agreement for resource planning				\$96K

TOTAL 2011 ESTIMATED SAVINGS \$20.6M