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BEFORE THE ARIZONA CORPORATION COMMISSION

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SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

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

NOTICE OF FILING DIRECT TESTIMONY

Tucson Electric Power Company ("TEP" or "Company"), through undersigned counsel, hereby files the Direct Testimony of David G. Hutchens and Denise Smith.

RESPECTFULLY SUBMITTED this 15th day of June 2012.

TUCSON ELECTRIC POWER COMPANY

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
GARY PIERCE- CHAIRMAN
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Direct Testimony of

David G. Hutchens

on Behalf of

Tucson Electric Power Company

June 15, 2012

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I. INTRODUCTION.

Q. Please state your name and business address.

A. My name is David G. Hutchens. My business address is 88 East Broadway Blvd., Tucson, Arizona 85702.

Q. By whom are you employed and what are your duties and responsibilities?

A. I am employed by UNS Energy Corporation ("UNS Energy") and Tucson Electric Power Company ("TEP" or the "Company") as President. UNS Energy was known as UniSource Energy Corporation before a name change that took effect on May 4, 2012. For simplicity's sake, I will refer to that company as UNS Energy throughout my testimony, even when describing actions taken under the company's previous name.

Q. Please describe your background and work experience.

A. I received a Bachelor of Science degree in Aerospace Engineering from the University of Arizona in 1988 and a Master of Business Administration degree from the University of Arizona's Eller Graduate School of Management in 1999.

I was commissioned into the United States Navy in 1988 and served as a Nuclear-Trained Submarine Line Officer until 1993.

I was hired by TEP in 1995 as an Analyst in Product Planning and Development. In 1996, I moved into TEP's Wholesale Marketing Department as an Energy Marketer/Trader. I was promoted to Supervisor of the area in 1999, Manager in 2001, and General Manager in 2003. I was promoted to Vice President of Wholesale Energy and UNS Gas in 2007 and the Vice President of Energy Efficiency and Resource Planning in 2009. In 2011, I was promoted to Executive Vice President of UNS Energy and in December I was promoted to my current position of President of UNS Energy and TEP.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide an overview of TEP's view of energy efficiency ("EE") resources and the potential impacts of the Arizona Corporations Commission's ("Commission") Electric Energy Efficiency rules (A.A.C. R14-2-2401 et seq.) ("EE Rules"). I am also setting forth the reasons that TEP is requesting approval of an interim EE Implementation Plan that will act as a bridge between now and the end of TEP's upcoming rate case. Finally, I explain that TEP will be proposing a different way – and what we believe to be a more effective way – to fund EE programs in an effort to meet the Commission's Energy Efficiency Standard ("EE Standard") set forth in the EE Rules in TEP's upcoming rate case.

Q. Could you please summarize your testimony?

A. Yes. First, TEP has been and continues to be a strong proponent of EE. However, due to unique circumstance surrounding the timing of the implementation of the EE Rules and TEP's rate case moratorium, there have been several challenges for TEP to meet the EE Standard. In order to avoid a confiscatory application of the EE Rules, TEP needs to be able to recover the lost fixed cost revenues resulting from compliance with the EE Rules. However, certain legal issues have been raised about adoption of a mechanism to recover those lost revenues outside of a rate case. Although TEP does not agree with those concerns, those potential legal issues provided some of the impetus to have an evidentiary hearing in this docket.

Second, in order to eliminate or mitigate those potential legal concerns and to implement a more robust EE program than is currently in place at TEP, the Company is proposing that the Commission approve a "bridge" implementation plan. TEP submitted such a modified plan in this docket on January 31, 2012 and then filed an updated version of the modified plan on May 2, 2012 ("Updated Plan"). Our position in this docket is that the Commission should approve the Updated Plan because it will provide a bridge to the end of the TEP rate case, where the Commission can approve a more coordinated solution, and it avoids an unduly confiscatory application of the EE Rules. TEP witness Denise Smith provides a more detailed explanation of the Updated Plan in her testimony.

Third, our "bridge" proposal is also important because TEP will be proposing a new way to fund EE in its upcoming rate case. In its rate case filing, TEP will propose a new, forward looking approach for financing EE programs and complying with the EE Standard. Under TEP's proposal, the Commission would approve a three (3) year EE investment plan and associated Demand Side Management Surcharges ("DSMS"). The Company will invest its capital in cost-effective demand side management and energy efficiency ("DSM/EE") programs, recovering its costs through the DSMS and eliminating the performance incentive. This approach should reduce the cost to TEP's customers compared to the existing approach set forth in the EE Rules and provide more stability and predictability regarding the level of the DSMS.

II. <u>THE DILEMMA OF THE EE RULES FOR TEP</u>.

Q. Please provide TEP's concerns about complying with the EE Rules.

A. At their core, the EE Rules require utilities to reduce their energy sales. The EE Rules are the latest in a series of Commission rules that are intended to change the way (i) utilities provide electric service; and (ii) customers pay for electricity. For example, in addition to the EE Rules, in recent years, the Commission has also promulgated separate sets of rules and issued decisions regarding Renewable Energy and Net Metering. These rules and orders result in reductions to the volume of sales to our customers without the requisite changes in cost recovery methods that would enable TEP to recover its costs and provide the Company with an opportunity to earn a reasonable return.

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

- 1.25% in 2011,
- a cumulative 3.0% in 2012, and
- a cumulative 5.0% in 2013 through the use of customer EE and demand response programs.

Successful implementation of any cost-effective DSM program will reduce TEP's kWh sales and revenues compared with the levels anticipated when the Company's current rates were approved. Under TEP's current rate design, for every 1.0% reduction in retail energy sales, its fixed costs recovered through volumetric rates (non-fuel revenue) is also reduced by 1.0%. Therefore, by 2013, TEP will be facing a decrease in non-fuel revenues of 5.0% from compliance with the EE Rule.

As part of Decision No. 70628, which approved TEP's 2008 Rate Case Settlement Agreement ("2008 Rate Case Settlement Order"), TEP's base rates are frozen until January 1, 2013, further exacerbating the situation. In other words, TEP is precluded from updating its base rates to reflect the lower sales volumes required by the Commission's EE Rule until 2013. TEP estimates that, without any recovery mechanism, it will lose a total of $39 million in fixed cost recovery from 2011 through 2013 with full compliance of the EE Rules.

Q. Was the Company an active participant in the electric EE Standard rulemaking process?

A. Yes, the Company was an active participant in the rulemaking process to adopt the EE Rules and to determine the EE Standard.

Q. Did the Company express concern about the EE Standard during the rulemaking process?

A. Yes, the Company filed the following documents:

- Comments to the Proposed Rules on November 16, 2009;
- Exceptions to the Recommended Order and Opinion on December 11, 2009;
- Comments on the EE Standard on February 16, 2010; and
- Exceptions to the Recommended Order and Opinion on July 6, 2010.

TEP also participated in workshops and public comment sessions during the rulemaking process. In filings, rulemaking workshops and public comment sessions, TEP repeatedly argued for synchronization of the EE Standard with an appropriate cost recovery mechanism. The Company also expressed its concerns about the mandated sales reductions and the adverse financial impacts on TEP during the term of its rate freeze.

Further, TEP was concerned about the lack of information regarding the definition of "cost-effective", the supply curve of available cost-effective programs, market penetration, technological issues and customer adoption rates– in short, the ability to meet such an aggressive standard in a cost-effective manner.

Q. Why isn't TEP requesting a waiver of the EE Rules until these issues are addressed in TEP's upcoming rate case?

A. TEP has always been a strong proponent of cost-effective EE as a means to keep customer rates down, to provide customers with the opportunity to manage their energy needs and to access low-cost energy resources. In fact, the Company was recently recognized by Target Rock Advisors Sustainability Rankings, as one of fifteen utilities in the United States that are industry leaders for demand-side management and energy efficiency ("DSM/ EE"). Although TEP has proposed a waiver of the EE Rules as an alternative to Staff of the Commission's (hereinafter "Commission Staff") Proposed Order, TEP has repeatedly indicated that it preferred the adoption of an Implementation Plan that would allow TEP to implement cost-effective programs that would enable the Company to meet the EE Standard, provided that the confiscatory impacts of the Plan were suitably ameliorated through appropriate synchronization of compliance with the EE Rules with timely recovery of lost fixed cost revenue.

Through Integrated Resource Planning efforts, the Company shows that certain DSM/EE measures can be the lowest cost generation resource available. It is well documented that EE can cost less than other resources and also helps to reduce peak loads. Further, EE reduces water consumption associated with traditional energy generation and in some instances EE can also reduce the need for new transmission and distribution investments.

Therefore, for the reasons set forth below, TEP would prefer to have a more robust interim EE plan approved by the Commission in this docket rather than to receive a waiver that effectively keeps TEP's EE spending at levels approved in 2010 before the EE Rules were adopted.

III. OVERVIEW OF TEP'S EE EFFORTS.

Q. Did the Company offer EE Programs prior to adoption of EE Rules on January 1, 2011?

A. Yes. The Company has offered a limited number of DSM/EE programs since the 1980's. However, the level of DSM/EE activity offered prior to adoption of the EE Standard is small compared to the level required to meet the EE Standard. Prior to 2009 the Company's DSM/EE programs produced savings of 0.3% or less of prior year sales. In compliance with the 2008 Rate Case Settlement Order, the Company increased its EE program offerings and continued to ramp up the level of program offerings in 2010 in anticipation of the EE Standard implementation.

Q. Was the Company allowed to recover program costs of all Commission approved DSM/EE Programs?

A. Yes. The company was allowed by the 2008 TEP Rate Case Settlement Order to recover all allowable program costs associated with implementing DSM/EE Programs. Approval to recover costs was also included in each individual Decision for the approved programs.

Q. Did the Commission also approve a utility performance incentive ("PI") for the Company?

A. Yes. The company was allowed by the 2008 Rate Case Settlement Order to include a utility PI. The approved PI structure allowed the Company to recover up to 10% of net benefits from the DSM/EE programs with a cap of 10% of costs, excluding costs for Low-Income Weatherization, Education and Outreach, and Demand Response Programs.

Q. Did the Company file an EE Implementation Plan as required by the EE Standard?

A. The Company filed its 2011 EE Implementation Plan on the January 31, 2011due date. The 2012 EE Plan was due on June 1, 2011. Because of the close proximity of due dates, the Company incorporated both requests into a 2-year EE Implementation Plan Filing. The Company requested expedited review and approval of the plan by June 1, 2011 to be in compliance with both the EE Standard and the DSMS adjustment implementation date.

Q. Since the filing of the EE Implementation Plan on January 31, 2011, there have been numerous filings in the docket. Can you identify the key filings?

A. The information in Table 1 below should be helpful in understanding the various filings since January 31, 2011, including the short-hand description of those filings.

Chronological Events Related To TEP EE Implementation Plan

Date	ACC Filing	Description	Reference
1/31/2011	TEP EE Implementation Plan	Original 2011-2012 EE Implementation Plan	EE Implementation Plan
6/30/2011	Notice of Filing	Supplemental information for EE Plan on monetization of environmental impacts.	EE Implementation Plan
8/22/2011	TEP Notice of Filing Updated Information	Filed updated information on Residential Financing, Program Budgets, Portfolio Savings, ARRT, and DSMS due to timing delay for EE Plan approval.	EE Implementation Plan
11/16/2011	Staff Proposed Order	Staff Proposed Order on EE Plan	EE Implementation Plan
12/2/2011	TEP Exceptions to Proposed Order	TEP Exceptions to Staff Proposed Order on EE Plan	EE Implementation Plan
1/5/2012	TEP Supplemental Comments to Staff's Proposed Order	TEP's Supplemental Comments to Staff's Proposed Order	EE Implementation Plan

1/10/2012	Open Meeting	Open meeting for EE Plan	EE Implementation Plan
1/31/2012	TEP Proposed Modified EE Plan	TEP Filed Modified EE Plan	Modified Plan
2/14/2012	TEP's Letter to Chairman Pierce	TEP Letter requesting hearing on Feb 23, 2012 Securities Open Meeting	Modified Plan
2/29/2012	Staff Amended Order	Staff Updates and Amended Order provides alternate proposals to Modified EE Plan.	Modified Plan
3/7/2012	TEP Comments to Staff's Update	Comments to Staff's updated alternate proposals.	Modified Plan
3/16/2012	Open Meeting	Open meeting for Modified EE Plan	Modified Plan
3/29/2012	Procedural Order	Procedural Order to refer Modified EE Plan to evidentiary hearing.	Modified Plan
5/2/2012	TEP Procedural Comments	Included Updated Plan	Updated Plan

I am not going to summarize the content of all of those filings. Our focus in this evidentiary hearing is the Updated Plan, which we filed on May 2, 2012, and which I will address below.

IV. <u>TEP's PROPOSED UPDATED MODIFIED IMPLEMENTATION PLAN</u>.

Q. What is TEP's proposed Updated Plan that was filed on May 2, 2012?

A. On May 2, 2012, TEP filed Procedural Comments and an Updated Plan. The Updated Plan was necessary to reflect the impact of the passage of time since TEP filed its Modified Implementation Plan on January 31, 2012. Specifically, the Updated Plan made modifications to the proposed budgets, interim PI and DSMS.

Q. How was the Modified Implementation Plan developed?

A. TEP submitted its Modified Implementation Plan in response to the discussions at the Commissions' January 10-11, 2012 Open Meeting. At that meeting, TEP and other interested parties, including Commission Staff, requested an opportunity to further discuss the issues surrounding the 2011-2012 Implementation Plan and to determine if a compromise proposal could be reached to present to the Commission for consideration. The Commission agreed to allow such discussions to take place and continued the Open Meeting agenda item.

TEP, Commission Staff, Residential Utility Consumer Office ("RUCO"), Arizonans for Electric Choice and Competition ("AECC") and Southwest Energy Efficiency Project ("SWEEP") met several times in person and by phone to discuss potential resolution of the issues. TEP provided an initial compromise proposal which was then modified based on the comments of the other participants. Although the Modified Implementation Plan appeared to have the conceptual support of all the participants, Commission Staff and AECC did not fully support the Plan.

Q. Could you provide an overview of the Modified Implementation Plan?

A. Yes, I can. The Modified Implementation Plan (filed on January 31, 2012) is the EE Plan on which the Updated Plan is based. This Modified Implementation Plan:

- Adopted the programs recommended for approval by Commission Staff, but at a funding level that is 75% of the amount recommended by Commission Staff;
- Adopted an Interim PI that: (i) encourages increased program benefits and results; (ii) provides a financial bridge to TEP's next rate case; and (iii) avoids the need for a significant waiver of the EE Rules for 2012;
- Did not incorporate TEP's proposed Authorized Revenue Recovery True-up ("ARRT") mechanism;

- Set the 2012 DSMS collection at $29,694,240, which is less than the $34,668,899 recommended by Commission Staff;
- Set the 2013 Implementation Plan budget at the same level as 2012 and retains the Interim PI, but allows TEP to propose modifications to the programs to improve the 2013 Implementation Plan effectiveness;
- Set the DSMS at $0.003608 per kWh for residential customers and at a rate of 4.19% on all charges (except taxes and other governmental assessments) for all other customer classes. The DSMS resulting from this Modified Implementation Plan results in incremental average bill impacts ranging from 2.39% to 2.94% for the various customer classes. The bill impact for the average residential customer would be $3.18/month, which would be an incremental bill impact of $2.08/month over the current DSMS bill impact of $1.10/month; and
- Provided TEP with a reasonable opportunity to meet the EE Standard for 2012, and perhaps, for 2013.

Q. Could you please summarize the Updated Plan?

A. As set forth in our May 2, 2012 filing, the Updated Plan effectively revises the Modified Implementation Plan to reflect the passage of time and the potential October 1, 2012 effective date for an adjusted DSMS. The Updated Plan:

- Adopts the programs recommended for approval by Commission Staff, but at a funding level that is 75% of the amount recommended by Commission Staff;
- Does not incorporate the ARRT mechanism or any other decoupling mechanism;
- Adopts a reduced interim PI that encourages increased program benefits and results:
- Sets a DSMS Collection for the 15 month period of **October 1, 2012 to December 31, 2013** at $27,894,412;

- Sets the DSMS at $0.002497 per kWh for residential customers and at a 2.86% rate on all charges (except taxes and other governmental assessments) for all other customer classes. This DSMS rate results in incremental average bill impacts ranging from 1.17% to 1.71% for the various customer classes. The bill impact for the average residential customer would be $2.20/month, which would be an increase of $1.10/month compared with the current average residential DSMS bill impact of $1.10/month.

TEP witness Denise Smith provides a more detailed explanation of the Updated Plan in her testimony.

Q. Why does TEP want the Commission to approve the Updated Plan?

A. The Updated Plan allows TEP to increase its EE programs well before the conclusion of its upcoming rate case, providing a more gradual ramp up of programs and costs needed to try to meet the Commission's EE Standard. The Updated Plan also represents a compromise position that still provides customers with cost effective programs to reduce their electric bill, stability to the DSM market place, and is a bridge mechanism to TEP's next rate case, where lost fixed cost recovery can be synchronized with TEP's future implementation plans.

Q. Will approval of this Updated Plan allow the Company to meet the EE Standard for 2012 and 2013?

A. No. Due to timing of approval for any of the EE Plans filed - and the cumulative nature of the EE Standard, the Company will not be able to meet the 2012 or 2013 EE Standard. However, it will provide TEP with the opportunity to narrow the compliance gap with the EE Standard in the future rather than the status quo.

Q. Will TEP need a waiver of the EE Standard for 2012 and 2013?

A. While we are not currently requesting a waiver, it is likely that a waiver will be required for 2012, 2013 and beyond depending on future Commission approvals of EE plans and the availability of cost effective EE resources.

V. <u>TEP'S UPCOMING PROPOSAL FOR FUNDING EE PROGRAMS</u>.

Q. What are the Company's plans for DSM/EE Programs in the future?

A. TEP will propose, in its July 2012 rate case application, a new, forward looking approach for financing DSM/EE Programs and complying with the EE Standard.

Q. What does the Company plan on proposing as an alternative to the current regulatory framework in its rate filing?

A. The Company believes there is an alternative solution for financing the cost of complying with the EE Standard that will reduce and stabilize the rate impacts to customers, better synchronize the benefits of EE with the costs, provide a base level of certainty to program offerings and eliminates the need to provide a PI to TEP. The Company's proposal is called the Energy Efficiency Resource Plan ("EE Resource Plan"). TEP's proposed EE Resource Plan would establish a three-year planning horizon for the Company's EE programs and the associated DSMS. The Company will invest its capital in cost-effective DSM/EE programs, recovering its costs through the DSMS and eliminating the PI. This capital investment and recovery model is similar to that used for any other supply-side resource except that the capital invested by the Company in cost-effective DSM/EE measures will be considered a regulatory asset.

Q. Why does TEP believe this approach is better than the current method of funding EE programs under the EE Rules?

A. The Company's proposed EE Resource Plan will be a win-win proposition for all stakeholders:(i) customers' will know in advance what the DSMS will be for multiple years and have assurances that programs and program funding will be stable over a multi-year timeframe; (ii) DSM/EE contractors will have more certainty regarding program funding levels; (iii) TEP will have more certainty related to the amount and timing of energy savings it can rely on in its resource and system planning; and (iv) this proposal reduces the annual burden that the DSMS review process puts on Commission Staff.

Q. Does this conclude your direct testimony?

A. Yes.

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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

Direct Testimony of

Denise Smith

on Behalf of

Tucson Electric Power Company

June 15, 2012

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Exhibits

I. INTRODUCTION.

Q. Please state your name and business address.

A. My name is Denise Smith. My business address is 88 E. Broadway, Tucson, Arizona 85702.

Q. What is your employment position?

A. I am the Director of Demand Side Resources at Tucson Electric Power Company ("TEP" or the "Company"), UNS Gas, Inc. ("UNS Gas") and UNS Electric, Inc. ("UNS Electric"), collectively referred to as the UNS Energy Corp.

Q. Please describe your background and work experience.

A. I graduated from Northern Arizona University ("NAU") earning a Bachelor of Science degree, in Mathematics with an extended major in Statistics, and then completed graduate work in Statistics at NAU. During my tenure at TEP, I completed a Masters of Business Administration at the University of Phoenix. After leaving NAU, I was hired by Pima Association of Governments in the Travel Reduction Program, which reduces vehicle emissions by targeting major employers to reduce employees' travel to and from work.

I was hired in 1996 by TEP as a Demand-Side Management ("DSM") Analyst, developing, analyzing and researching new DSM and energy-related market programs. In addition, I implemented and reported progress of existing DSM programs and then transitioned them into market-transformation programs. In 1999, I moved into the Pricing and Rates Department, and developed cost-of-service and revenue requirement models. In 2002, I was promoted to the Director of the Pricing and Rates Department. I then accepted the position of Director of Conservation and Renewable Programs. During my tenure as Director of Conservation and Renewable Programs and more recently

Director of Demand Side Resources I have overseen the implementation and management of 29 new DSM programs. I also managed the successful design and implementation of several Renewable energy programs for TEP and UNS Electric.

Q. Please provide a summary of your testimony.

A. Because of extenuating circumstances surrounding the 2011-2012 Energy Efficiency ("EE") Implementation Plan, the Company had to restrict DSM/EE Program Budgets to an amount that can be recovered, along with other approved costs, through the Demand Side Management Surcharge ("DSMS") approved in Decision No. 71720 (June 3, 2010). Participation in DSM/EE programs for customers in the TEP service territory are now limited and budgets have been significantly reduced. The Company's intended progress toward meeting the savings targets outlined in the Commission's Electric Energy Efficiency Rules AAC R14-2-2401 et seq. ("EE Rule") has been severely disadvantaged, creating a ripple effect that will handicap TEP's ability to achieve both short-term and long-term EE targets that are mandated by the Commission. In order to reduce further erosion of TEP's ability to meet the EE Standard set forth in the EE Rules, TEP is proposing that the Commission approve the Updated EE Implementation plan by October 1, 2012. This will provide significant net-benefits to all customers, provide programs that enable customers to reduce electric consumption, provide stability to the DSM marketplace and provide a bridge mechanism between now and the conclusion of TEP's rate case, which will be filed in early July 2012.

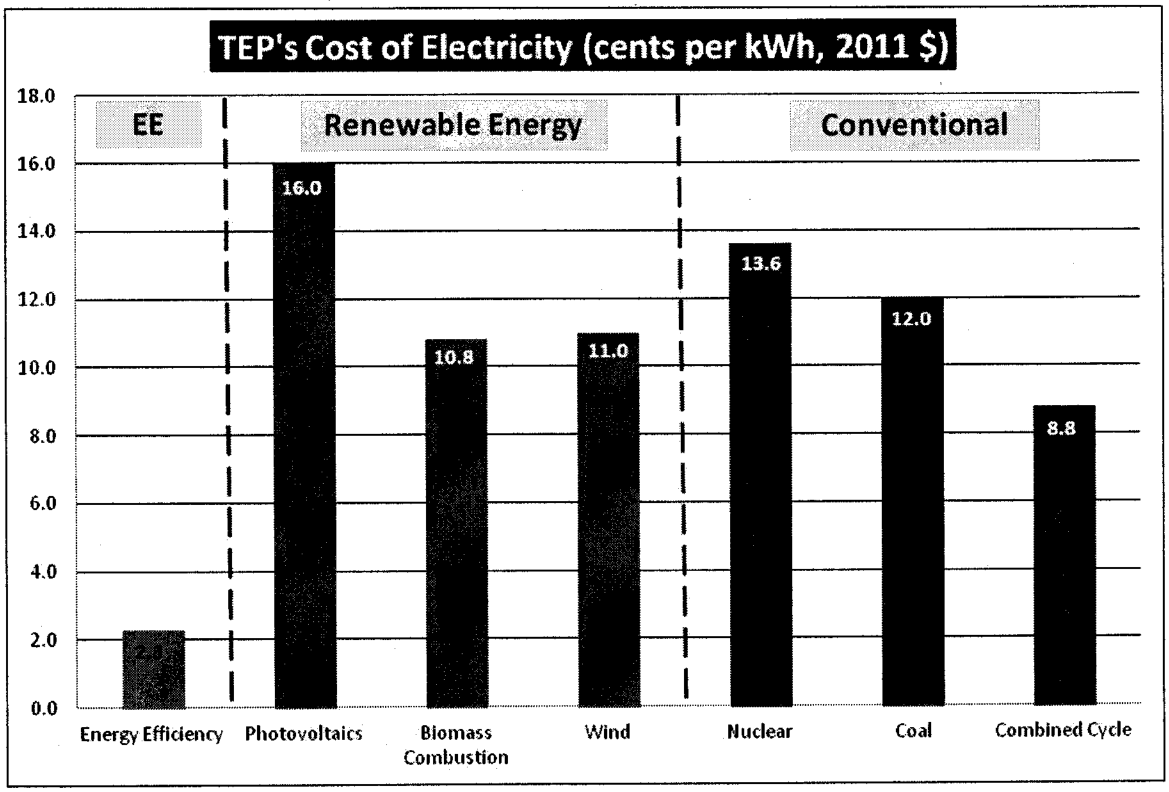
IV. CURRENT STATUS OF TEP'S EE PROGRAMS.

Q. Does the Company support DSM/EE as a cost-effective supply-side resource?

A. Yes. As mentioned in Mr. Hutchens's testimony the Company supports cost-effective EE that provides value to our customers. The Company takes several steps to ensure each measure within each EE Program is cost effective and represents an accurate picture of the Company's costs. Those steps include:

- Comprehensive research on equipment/measures to determine both baseline and EE savings potential (both kWh and kW);
- Comprehensive research to acquire incremental costs and equipment/measure life;
- Comprehensive research to gather information and develop hourly load profiles from each type of equipment/measure;
- Determination of avoided utility costs from the Company's most recent Integrated Resource Plan;
- Development of budgets and participation estimates for each proposed measure and program;
- Preparation of cost-effectiveness calculations for each EE measure and program using the Societal Cost Test as required in the EE Rule; and
- Comprehensive analysis of the total EE Savings (resource) to traditional and non-traditional supply-side resources.

The table below shows the cost comparison of resources of EE to other traditional and non-traditional resources with information filed in TEP's 2012 Integrated Resource Plan. Investments in cost-effective EE can also reduce the impact on water resources, emissions, and other non-energy related benefits such as thermal comfort in homes/businesses, jobs, and indoor air quality.



Q. Does the Company offer DSM/EE savings opportunities to customers within the TEP service territory?

A. Yes. The Company received Commission approval to implement several DSM/EE programs in 2008 in anticipation of the implementation of the EE Rule and a handful of programs had received prior Commission approval dating back to the 1980's. These programs include:

- Low-Income Weatherization Program
- Existing Homes Program
- Residential New Construction Program
- Shade Tree Program
- Non-Residential Existing Facilities
- Small Business Direct-Install
- CFL Buy-Down
- Efficient Commercial Building Design (Pilot Program)

- Education and Outreach
- C&I Direct Load Control Program
- Zero-Energy New Homes Program (Pilot Program)
- Residential and Small Commercial Direct Load Control Program (Pilot Program)
- TEP Energy Assessment
- Home Energy Reports

Q. Was the Company allowed to recover costs of all Commission approved DSM/EE?

A. Yes, Decision No. 70628 (December 1, 2008) authorized TEP to recover all allowable costs associated with implementing DSM/EE Programs including a utility Performance Incentive ("PI"). Approval to recover costs for some of the above mentioned programs was also included in other Commission Decisions.

Q. Describe the mechanism allowed by the Commission for cost recovery.

A. The initial DSMS Adjustor was established on December 1, 2008, in Decision No. 70628. The Company is required to file for approval of an adjustment to the DSMS on April 1st of each year, with any adjustment taking effect on June 1st of the same year. The Adjustor Filing requires the Company to include documentation on actual program spending for the previous 12 months, projected program budgets for the following 12 months, and a true-up of any over or under collection. In addition the Company is required to document the calculation on its PI, including program net benefits and program spending (less Low-Income Weatherization, Education and Outreach, and Demand Response programs). The DSM adjustor is applied to customer's bills as a per kWh charge.

Q. When was the DSMS adjustor last modified?

A. The last DSMS was approved in June 2010 in Decision No. 71720 (June 3, 2010). This decision set the DSMS to allow recovery of the 2010 estimated Program Expenses, a 2009 PI, and some under-recovery of previous years' program costs. Since the reset in 2010, the Company received approval to implement new programs and to spend additional monies, but the Commission has not authorized TEP to recover the costs of those new or expanded programs. This lack of synchronization has had a significant financial effect on TEP and has reduced its ability to continue funding EE programs at those previously established levels. Approval of TEP's 2011-2012 EE Implementation Plan as modified in this proceeding would remedy those issues.

Q. Has the Company received approval of the EE Implementation Plan?

A. No, the Company has not received approval of the EE Implementation Plan.

Q. What is the current status of TEP's DSM/EE Programs?

A. As a result of the discussion and vote at the Commission's March 16, 2012 Open Meeting, the Company modified its DSM/EE Programs to reflect the status quo funding generated by the existing DSMS. The primary modifications included:

- Rather than continuing to increase the burden on customers by continuing DSM/EE spending at a level greater than collections and increasing the lost fixed cost burden on the Company, TEP reduced program spending to previous levels as to better synchronize recovery of approved DSM/EE costs with the current DSMS approved June 3, 2010.
    - To determine the actual amount available for program spending, the Company estimated its annual revenue collections from the current DSMS ($11 million) and compared it with the TEP's under-recovered costs as of December 31, 2011 ($6.5 million).

- Based on the level of annual DSMS collections, it was TEP's belief that in order to maintain a marginal level of DSM/EE program funding, it would extend the collection of its $6.5 million in under-recovered costs over a two year period. Based on this decision, the annual program budgets were reduced to $7.5 million per year.

With a $7.5 million annual program budget, TEP reduced program budgets across the board with the exception of Low-Income Weatherization.

The following explains the program changes:

- The Multi-Family Direct Install Program, Schools Facility Program, Retro-Commissioning Program, Bid for Efficiency Program, Behavioral Comprehensive Program, and Combined Heat and Power Joint Program had not been approved during previous Commission hearings so all programs are on hold and will not go forward until approved by the Commission.
- Although the Appliance Recycling Program was not previously approved by the Commission, the Company had already selected an implementation contractor ("IC"). The contractor was notified that the program would not be implemented as planned. The TEP plan for an Appliance Recycling Program is on hold and will not go forward until approved by the Commission.
- Although the Residential Financing Program was not previously approved by the Commission, the Company had already selected a program lender. The lending partner was notified that the program would not be implemented as planned. The TEP plan for a Residential Financing Program is on hold and will not go forward until approved by the Commission.
- Participation in the Large Business and Small Business Direct-Install Program was very active. However, the reduction in funds for these programs resulted in

the suspension of these programs effective in March 2012 until additional funding is made available. The IC responsible for these two programs was notified and made necessary modifications and reduced staff assigned to the Company from 6 to 2. Program information was removed from the Company website. Because it was necessary to reallocate the remaining implementation funding toward the payment of incentives for work completed, no funds are available for either incentives or implementation and the program has been fully suspended for the remainder of the program year.

- The Existing Home Program has been suspended as the incentives already paid plus incentives approved for payment have exhausted incentives available at the reduced funding level. TEP notified the IC of this situation and the Company provided the required 30 day notice of cancellation for the contract. The IC made necessary modifications and reduced staff assigned to the Company from 8 to 0. The IC has indicated to TEP that it is now in the process of closing the local office. With the small amount of funds still available to operate the Existing Homes Program, the Company began development of an alternate plan to continue offering certain pieces of the program without incentive payments. The Company hopes to at least maintain some interest in the program until additional funding is approved by the Commission.
- The partner in the Shade Tree Program was notified of the reduced funding so they could reduce activity for the remainder of 2012.
- The Company notified the IC providing Home Energy Reports of reduced funding for 2012 but the Company decided to continue mailing the existing reports through September 2012 to complete the cycle and provide the Company with one full year of available data and savings. After September 2012, the Home Energy Reports program may be suspended unless additional funding is approved by the Commission.

- The Company notified the IC for the CFL Buy-Down program of reduced budgets for 2012 and 2013. The IC supplied an alternative work plan with reduced buy-down incentives in attempts to continue with program activity through 2012 and 2013.
- The Company notified the IC for the C&I Direct Load Control program of the reduced funding level and suspended signing on new customers to the program until additional funding is available.
- The Company notified home builders participating in the Residential New Construction Program of reduced budgets and that participation would continue until funding was no longer available. Builders were notified that incentives would be made on a first-come-first served basis but the program would be suspended in the near future. Funds were exhausted or reserved the last week of May and the New Home Construction Program was suspended effective May 31, 2012.

III. <u>TEP's UPDATED MODIFIED IMPLEMENTATION PLAN.</u>

Q. Mr. Hutchens stated that TEP is now proposing the Updated Plan, which is an EE Implementation Plan that acts as a bridge to the end of the upcoming rate case. Please provide a summary of details for the Updated Plan proposed by TEP.

A. As Mr. Hutchens testified, the Updated Plan:

- Adopts the programs recommended for approval by Commission Staff in the Proposed Order dated November 16, 2011, but at a funding level that is 75% of the amount recommended by Staff;
- Does not incorporate the Authorized Revenue Recovery True-up ('ARRT') mechanism or any other decoupling mechanism;

- Adopts a reduced interim PI that encourages increased program benefits and results; and
- Sets a DSMS collection for the period of October 1, 2012 to December 31, 2013 at $27,894,412 which includes $18.5 million for Program Budgets, $3.9 million for estimated under-recovery of previous expenses as of September 30, 2012, $2.2 M for the 2010 and 2011 PI, and $3.3 million for a 2012 PI; and
- Sets the DSMS at $0.002497 per kWh for residential customers and at a 2.86% rate on all charges (except taxes and other governmental assessments) for all other customer classes. This DSMS rate results in incremental average bill impacts ranging from 1.17% to 1.71% for the various customer classes. The bill impact for the average residential customer would be $2.20/month, which is an increase of $1.10/month over the current average residential DSMS bill impact of $1.10/month.

This Updated Plan allows TEP to increase its EE programs well before the conclusion of its upcoming rate case, providing a smoother ramp up of programs and costs needed to try to meet the Commission's EE Standard. The Updated Plan also represents a compromise position that still provides net benefits to all customers, provides programs for customers to reduce their electric bill, provides stability to the DSM market place, and provides a bridge mechanism to TEP's next rate case, where lost fixed cost recovery can be synchronized with TEP's future implementation plans. The Updated Plan, filed May 2, 2012, is attached as **Exhibit DS-1**.

Q. **Please identify the programs proposed by the Company that Staff recommended for approval in its November 16, 2011 Proposed Order.**

A. The November 16, 2011 Proposed Order recommended approval of the following new Programs:

- Multi-Family Direct Install
- Retro-Commissioning
- Schools Facilities
- Bid-For-Efficiency
- Residential Financing
- Behavioral Comprehensive
- Combined Heat and Power

The Proposed Order also recommended updated budgets for existing programs and recommended approval of new measures within the following Programs:

- Low-Income Weatherization Program
- Existing Homes Program
- Residential New Construction Program
- Shade Tree Program
- Non-Residential Existing Facilities
- Small Business Direct-Install
- CFL Buy-Down
- Efficient Commercial Building Design (Pilot Program)
- Education and Outreach
- C&I Direct Load Control Program
- Zero-Energy New Homes Program (Pilot Program)
- Residential and Small Commercial Direct Load Control Program (Pilot Program)
- TEP Energy Assessment
- Home Energy Reports

These programs are fully described in TEP's 2011-2012 EE Implementation Plan, which the Company will be submit as an Exhibit at the evidentiary hearing.

Q. What is the funding level for each program in the Updated Plan?

A. The proposed funding level for each program is shown in Table 1 below. This funding will cover the full 15 month period proposed for the Updated Plan (October 1, 2012-December 31, 2013).

Table 1: TEP Updated EE Plan Budgets

Program	Updated Plan Budget
Efficient Products	$2,453,253
Appliance Recycling	$755,095
Res. New Construction	$1,011,949
Existing Homes and Audit Direct Install	$2,304,525
Shade Tree	$250,681
Low Income Weatherization	$526,464
Multi-Family	$181,565
Residential Direct Load Control - Pilot	$167,864
Subtotal	**$7,651,396**
C&I Comprehensive Program	$3,728,462
Commercial Direct Load Control	$1,431,445
Small Business Direct Install	$2,044,806
Commercial New Construction	$515,702
Bid for Efficiency - Pilot	$388,846
Retro-Commissioning	$336,493
Schools Facilities	$170,049
CHP Joint Program - Pilot	$22,000
Subtotal	**$8,637,804**
Home Energy Reports	$699,197
Behavioral Comprehensive Program	$724,151
Subtotal	**$1,423,349**
Education and Outreach	$155,250
Residential Energy Financing	$315,405
Codes Support	$73,288
Program Development, Analysis, and Reporting Software	$276,115
Subtotal	**$820,058**
Total	**$18,532,606**

Q. If the Updated Plan is approved, what will happen if the proposed EE Resource Plan (discussed in Mr. Hutchens testimony) that will be filed with TEP's upcoming rate case is approved prior to December 2013?

A. In the event that the proposed EE Resource Plan is approved in the rate case prior to December 31, 2013, the actual spending and revenue collections on the effective date of the rate case decision would be used to determine any over or under recovery amount to true-up in the new DSMS adjustment. At that time, the new EE Resource Plan, with budgets approved within the rate case decision, would become effective and this interim "bridge" plan would end.

Q. What will the DSMS be under the Updated Plan?

A. The Updated Plan establishes the DSMS at $0.002497 per kWh for residential customers and at a 2.86% rate on all charges (except taxes and other governmental assessments) for all other customer classes. This DSMS rate results in incremental average bill impacts ranging from 1.17% to 1.71% for the various customer classes. The bill impact for the average residential customer would be $2.20/month, which would be a net bill impact of $1.10/month over the current DSMS bill impact ($1.10/month).

Q. The Updated Plan contains an interim PI. Please describe how the interim PI works.

A. The Interim PI is based entirely on the Company's performance in delivering cost-effective EE programs to customers in its' service territory. This Interim PI is divided into two parts; (1) a base PI; and (2) additional performance metrics.

1. The Base PI.

The base PI includes 7% of the net benefits achieved from EE Programs delivered during 2012. The Participants have agreed to a tiered structure for the base PI allowing for a lower payment if TEP meets 80% of the EE net benefits goal and a higher payment if the Company meets up to 120% of the goal. Net benefits are determined by subtracting the calculated Societal Cost of program delivery from the calculated Societal Benefits derived through those same EE programs. Thus, net benefits will be greater if program costs are kept low while delivering increased societal benefits. Both the tiered payment structure and payment based on net benefits create an atmosphere that encourages the Company to deliver the most cost-effective and highly beneficial programs and measures at the lowest possible cost.

2. Additional Performance Metrics

Part 2 of the proposed Interim PI consisted of five (5) specified performance metrics. Payments would be made on individual metrics, meaning the Company may receive payment on some individual metrics but not others. These additional performance metrics follow the same tiered structure with 80% being the floor value and 120% being the maximum value.

The calculation for the 2012 Shared Benefits PI is shown in Table 2 below.

Table 2: 2012 Shared Benefits PI

Energy Efficiency Shared Benefits
DSM Program Year 2012

Part I - Base Performance Incentive	
DSM Costs	$ 11,040,296
2012 Net Benefits	$ 22,626,485
Shared Savings	7.00%
Part 1: Base Energy Efficiency Shared Benefits (net benefits times 7.0%)	**$ 1,583,854**

Part II - Other Performance Metrics	Target	Dollars
Net Benefit per customer dollar spent (net benefits/actual spending)	2:1 Ratio	$ 1,100,000
Community weatherization workshops	30	$ 150,000
Community outreach – monthly outreach to Seniors on EE (Starting Oct)	4	$ 150,000
Loan program – train contractors on TEP's new loan program	8	$ 150,000
Low Income Weatherization – 5% increase in participation over 2011	163	$ 150,000
Part II: Other Performance Metrics at 100% of Goal		**$ 1,700,000**
Total New Performance Incentive for 20120		
At 80% of Goal		$ 2,627,083
At 100% of Goal		**$ 3,283,854**
At 120% of Goal		$ 3,940,625

Q. Is TEP currently recovering a PI?

A. Yes. The 2008 Rate Case Settlement Agreement approved in Decision No. 70628 authorized TEP to recover a PI. The approved PI structure allowed the Company to recover up to 10% of net benefits from the DSM/EE programs with a cap of 10% of costs, excluding costs for Low-Income Weatherization, Education and Outreach, and Demand Response Programs. A PI is expressly permitted by the EE Rules.

Q. Is it critical to have the Updated Plan and the DSMS for this plan approved on October 1, 2012?

A. Yes. In order to for the Company to have sufficient time to collect the proposed budget through the DSMS proposed in the Update Plan, TEP must begin collections through the new DSMS on October 1, 2012. An October 1, 2012 approval for proposed program budgets will also allow the Company to lift restrictions on existing program participation and begin to ramp-up new program offerings in an effort to meet the EE Rule in 2013.

In addition, the Company, in cooperation with the State of Arizona, has been awarded a U.S. Department of Energy grant for "Smart Grid Data Access" to study the savings potential from installation of residential in-home displays. However as with any grant application there is a requirement for the Company to provide a portion of the project costs. In order to comply with the commitment made during the application process, TEP must provide a total of $677,450 in matching funds, equipment and support for the grant. If TEP does not receive approval of the Updated Plan by October 1, 2012, the Company could be at risk of losing the grant.

Q. How will the Updated Plan help TEP ultimately meet the EE Standard?

A. Because of the delay in the timing of the approval of the EE Plan, the Updated Plan itself will not result in TEP meeting the EE Standard for 2012 or 2013. However it will provide a better foundation to build on than maintaining the status quo until the conclusion of TEP's rate case. TEP will be able to start some new programs and expand some existing programs. Allowing this gradual expansion will smooth the costs of compliance and put TEP closer on the track for narrowing the compliance gap with the EE Standard.

Q. Does this conclude your direct testimony?

A. Yes.

EXHIBIT

DS-1

Tucson Electric Power

Updated Modified Plan for TEP's 2012-2013 EE Plan

The changes in this updated modified plan ("Updated Plan") are updates to the Modified Implementation Plan (filed January 31, 2012) ("Compromise Plan') due to anticipated timing of approval of the Updated Plan and subsequent program performance. The numbers in the Updated Plan are calculated based on an assumed implementation plan start date of October 1, 2012.

1. **TEP DSM program budgets.**

In the Compromise Plan, TEP and parties agreed to reduce its 2012 proposed $24.7 million program budget by 25%, to $18.5 million. The updated modified plan would spread the $18.5 million in DSM program budgets over a 15 month period to cover an assumed start date of October 1, 2012 through December 31, 2013. Specific program budgets are shown in Table 1.

TEP will not meet the EEES for either 2012 or 2013 under the Updated Plan and will need a waiver from the EEES for 2012 and 2013.

2. **2013 Implementation Plan.**

TEP will request a waiver of filing its 2013 Implementation Plan as the Updated Plan will encompass 2013.

3. **The unrecovered balance will be collected over a 15 month period.**

TEP estimates there will be an unrecovered balance as of September 30, 2012 totaling $6.1 million related to the period 2008 - 2011. This balance includes $3.9 million of unrecovered program costs, the 2010 performance incentive of $1.1 million and the 2011 performance incentive of $1.1 million.

4. **TEP will implement an updated revised interim 2012 Performance Incentive titled "Energy Efficiency Shared Benefits."**

As an interim Performance Incentive titled "Energy Efficiency Shared Benefits" until a replacement is approved in the rate case, TEP will implement a methodology similar to one suggested by SWEEP. This incentive includes two components, a base amount calculated as 7.0% of net benefits and an additional amount based on other key metrics.

This updated proposal reduces TEP's requested performance incentive from $7.2 million in the compromise plan to $3.3 million for the year 2012, with a floor of $2.6 million and a ceiling of $3.9 million. The Energy Efficiency Shared Benefits will be trued-up in the 2012 rate case proceeding. See Table 3 for details.

5. TEP reduces its requested DSMS.

TEP will decrease its requested DSMS from $0.003608 per kWh (in the Compromise Plan) to $0.002497 per kWh for residential customers and to a 2.86% rate for all other customer classes (in the Updated Plan). The rate has been adjusted to reflect recovery of a 15 month timeframe. Table 2 sets forth a comparison of the overall budgets of the Compromise Plan and the Updated Plan. Table 4 shows the average incremental increases and bill impacts by customer class. These DSMS rates will remain in effect until changed by further order of the Commission.

TABLE 1: TEP Program Budgets (Oct. 2012 – Dec. 2013)

Program	Cost
Efficient Products	$2,453,253
Appliance Recycling	$755,095
Res. New Construction	$1,011,949
Existing Homes and Audit Direct Install	$2,304,525
Shade Tree	$250,681
Low Income Weatherization [1]	$526,464
Multi-Family	$181,565
Residential Direct Load Control - Pilot	$167,864
Residential Subtotal	**$7,651,396**
C&I Comprehensive Program	$3,728,462
Commercial Direct Load Control	$1,431,445
Small Business Direct Install	$2,044,806
Commercial New Construction	$515,702
Bid for Efficiency - Pilot	$388,846
Retro-Commissioning	$336,493
Schools Facilities	$170,049
CHP Joint Program - Pilot	$22,000
Commercial Subtotal	**$8,637,804**
Home Energy Reports	$699,197
Behavioral Comprehensive Program	$724,151
Behavioral Subtotal	**$1,423,349**
Education and Outreach	$155,250
Residential Energy Financing	$315,405
Codes Support	$73,288
Program Development, Analysis and Reporting Software	$276,115
Support Subtotal	**$820,058**
Total	**$18,532,606**

TABLE 2: TEP 2012-2013 Overall Budget Comparison

	Compromise Plan (March 2012-December 2013)	Updated Plan (October 2012 - December 2013)
Budget		
2012 Program Budget	$18,532,606	
2013 Program Budget	$18,532,606	
2012 - 2013 Program Budget (10/1/12 start date) [1]		$18,532,606
Carry Over Balance	$5,614,113	$3,861,556
2010 Performance Incentive	$1,114,648	$1,114,648
2011 Performance Incentive	$1,101,749	$1,101,749
2012 Performance Incentive	$7,246,379	$3,283,854
2013 Performance Incentive	$7,246,379	TBD in Rate Case
Total	**$59,388,980**	**$27,894,412**
Tariff		
2012-2013 Forecasted MWh (22 months)	16,461,914	
2012-2013 Forecasted MWh (15 months)		11,170,724
Residential Tariff (per kWh)	$0.003608	$0.002497
Non-Residential Tariff	4.19%	2.86%

(1) TEP estimates it will spend $6.2 million on DSM programs from January 2012 through September 2013. This expense will be covered by the collection of the existing DSMS through September 2013

TABLE 3: Interim Performance Incentive

Energy Efficiency Shared Benefits
DSM Program Year 2012

Part I - Base Performance Incentive		
2012 DSM Costs		$11,040,296
2012 Net Benefits		$22,626,485
Shared Savings		7%
Part I - Base Energy Efficiency Shared Benefits (net benefits times 7.0%)		**$1,583,854**

Part II - Other Performance Metrics	Target	Dollars
Net Benefit per customer dollar spent (net benefits/actual spending)	2:1 ratio	$1,100,000
Community weatherization workshops	30	$150,000
Community outreach – monthly outreach to Seniors on EE (starting Oct)	4	$150,000
Loan program – train contractors on TEP's new loan program	8	$150,000
Low Income Weatherization – 5% increase in participation over 2011	163	$150,000
Part II: Other Performance Metrics at 100% of Goal		**$1,700,000**

Total New Performance Incentive for 2012	
At 80% of Goal	$2,627,083
At 100% of Goal	**$3,283,854**
At 120% of Goal	$3,940,625

TABLE 4: Average Bill Impact

Average Bill Impact	Current DSMS	Proposed DSMS	Dollar Increase	Total Bill % Increase
Residential	$1.10	$2.20	$1.10	1.17%
Small Commercial	$5.37	$13.60	$8.23	1.71%
Large Commercial	$200	$460	$260	1.60%
Industrial	$1,874	$3,393	$1,519	1.26%