

1 During the subsequent evidentiary hearing process, the parties were provided the
2 opportunity to raise any relevant legal issues. Significant legal issues were raised, briefed and
3 argued during the hearing. The Recommended Opinion and Order (“ROO”), prepared by the
4 Administrative Law Judge who presided over the matter, has addressed those legal issues. The
5 Joint Respondents believe that the ROO presents the legally defensible resolution of the issues
6 surrounding approval of an implementation plan for TEP that the Commission desired.

7 RESPONSE TO LEGAL ISSUES

- 8 **1. Does the Commission have legal authority to change the formula for**
9 **calculating TEP’s energy efficiency performance incentives outside a rate**
10 **case?**

11 Yes. The express language of the Electric Energy Efficiency Rules, A.A.C. R-14-2-2401
12 et seq. (“EE Rules”), the legislative history of the EE Rules, and sound public policy provide the
13 Commission with the legal authority to change TEP’s performance incentive outside a rate case.²

14 First, the plain and unambiguous language in A.A.C. R14-2-2411 expressly provides that
15 the Commission can consider a performance incentive in the annual implementation plan review
16 process to encourage and reward a utility for achieving the energy efficiency standard:

17 In the implementation plans required by R14-2-2405, an affected utility may
18 propose for Commission review a performance incentive to assist in achieving the
19 energy efficiency standard set forth in R14-2-2404. The Commission may also
consider performance incentives in a general rate case.³

20 The EE Rules unequivocally state that it is appropriate for the Commission to review the
21 performance incentive when requested by an affected utility. Although the EE Rules acknowledge
22 that performance incentives “*may also*” be addressed in a rate case, the EE Rules do not *require* it.

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26 ² As part of the evidentiary hearing, the parties were provided the opportunity to submit briefs or to
provide argument on legal issues. TEP submitted a legal brief on performance incentive issues on July 6,
27 2012. During the closing statements, other parties addressed legal issues related to the proposed interim
performance incentive. The other joint respondents concurred with TEP’s legal brief at that time.

³ Emphasis added.

1 Second, a review of the rulemaking process, and particularly the evolution of Rule 2411,
2 reveals that Rule 2411 was intended to provide for ongoing review and, potentially, revision to a
3 utility's performance incentive. The initial draft of the EE Rules (issued on October 30, 2009),
4 set forth a specific structure for performance incentives:⁴

- 5 A. An affected utility that achieves 85% compliance with the annual energy
6 efficiency standard in a calendar year, calculated as provided in subsection
7 (B) may recover in the following calendar year, through its Commission-
8 approved cost recovery mechanism, a performance incentive established as
9 provided in the table below:

10 Level of Compliance with Annual 11 Energy Efficiency Standard 12 Achieved (Excluding Net Benefits 13 from Demand Response)	14 Performance Incentive as a 15 Percentage of Net Benefits 16 from Energy Efficiency 17 Programs	18 Performance 19 Incentive Capped at 20 a Percentage of 21 Program Costs
22 85% to 95%	23 6%	24 12%
25 96% to 105%	26 7%	27 14%
28 106% to 115%	29 8%	30 16%
31 116% to 125%	32 9%	33 18%
34 Above 125%	35 10%	36 20%

- 37 B. An affected utility shall not include net benefits derived from demand-
38 response programs when calculating compliance with the annual energy
39 efficiency standard for purposes of determining the performance incentive
40 under this Section.

41 Several stakeholders, however, expressed concerns with having a specific performance
42 incentive standard set forth in the EE Rules. Those stakeholders indicated their preference to
43 have such performance incentives considered in connection with the implementation plans, so
44 that the incentives are tied to the objectives of a specific program portfolio and take into account
45 changed circumstances over time without having to go through another rulemaking process.⁵ In
46 response to these concerns, the Commission amended A.A.C. R14-2-2411 to simply state that:
47 "In the implementation plans required by R14-2-2405, an affected utility may propose for
48 Commission review a performance incentive to assist in achieving the energy efficiency standard
49 set forth in EE Rules. The Commission may also consider performance incentives in a general

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51 ⁴ See proposed A.A.C. R14-2-2411 in Staff's October 30, 2009 Memorandum (Docket No. RE-00000C-09-
52 0427).

53 ⁵ See Comments of Southwestern Energy Efficiency Project ("SWEEP"), Letter from National Resources
54 Defense Council, and Letter from Sierra Club in Docket No. RE-00000C-09-0427 (December 11, 2009).

1 rate case.” The intent of the new language was to determine the structure of performance
2 incentives primarily during the evaluation of implementation plans, although it left open the
3 option to determine such a structure in a rate case. This new language was approved in Decision
4 No. 71436 (December 18, 2009) which opened the rulemaking docket for the EE Rules. The
5 final EE Rules were approved in Decision No. 71819 (August 10, 2010) with the amended
6 performance incentive language intact.

7 Third, it is important to note that at the time the Commission adopted the EE Rules, it was
8 aware that there were existing Demand-Side Management (“DSM”) programs and surcharges that
9 might need to be modified in connection with the new implementation plans and EE Standard.
10 For example, Rule 2406.C provided that an existing DSM adjustment mechanism (which typically
11 had been approved in a rate case) could be modified upon the filing of certain information. The
12 Commission was also aware that there were performance incentives that had been previously
13 approved, but decided to allow utilities to propose new performance incentives in connection with
14 a new implementation plan (as discussed above).

15 Fourth, sound public policy supports the ability to adopt a performance incentive that is
16 related to an implementation plan *at the time* the implementation plan is considered and adopted.
17 Modifying TEP’s current performance incentive to better match the new Updated Plan is in the
18 public interest. TEP’s current performance incentive was approved in TEP’s last rate case, in
19 Decision No. 70628 (December 1, 2008) – prior to the adoption of the EE Rules.

20 In its Updated Plan, TEP proposes a new interim performance incentive that incents cost-
21 effective DSM/EE programs and actual performance. Specifically, the interim “Energy Efficiency
22 Share Benefits” will include: (1) a base amount calculated as 7.0% of net benefits and (2) an
23 additional amount based on key metrics designed to accelerate implementation of certain approved
24 programs. This incentive structure is preferable over the current incentive and is more appropriate
25 for the Updated Plan because it encourages programs to achieve net-benefits for customers,
26 consistent with the objectives of the Updated Plan, and focuses TEP’s efforts on the key metrics
27 designed to support the achievement of the customer net benefits. The performance incentive also

1 encourages prompt ramping up of the programs to ensure that the funds being collected will be
2 used to reduce utility bills and provide benefits to customers in a timely manner.

3 Fifth, previously the Commission approved a new performance incentive for UNS Electric
4 outside of a rate case (Decision No. 72747), and did so by citing the language in the EE Rules
5 (A.A.C. R14-2-2411). TEP, in the Updated Plan, is proposing a new performance incentive for
6 Commission consideration, on which the Commission should act using the same justification it
7 used to approve the UNS Electric performance incentive.

8 Given the express language and history of the EE Rules, the underlying rationale of that
9 language, prior Commission action and the purpose of performance incentives, the Commission is
10 well within its authority to modify a performance incentive outside of a rate case.

11 **2. If the answer to the first question is yes, must the parties to a rate decision,**
12 **which establishes a performance incentive formula, have notice within the**
13 **pendency of the rate case that the Commission may change the performance**
14 **incentive formula outside of either that rate case or a future one?**

15 No. It is not necessary to provide notice to such parties during the pendency of a rate case
16 that the performance incentive addressed during that rate case may be changed in the future. First,
17 the Commission always has the authority under A.R.S. § 40-252 to modify a decision upon proper
18 notice and opportunity to be heard. Thus, all parties have constructive notice that a decision could
19 be modified at some future date.

20 Second, the rulemaking process that led to the EE Rules (and the EE Rules themselves)
21 also provided constructive notice to stakeholders that a different performance incentive could be
22 proposed and adopted in connection with a new implementation plan submitted pursuant to the EE
23 Rules.

24 Third, the above notwithstanding, TEP did in fact provide timely notice to the parties in the
25 2008 Rate Case that TEP was proposing to modify the performance incentive adopted in that
26 case.⁶ That notice was provided well before the evidentiary hearing in this docket. No party to the

27 ⁶ On January 31, 2012, at the suggestion of Staff, TEP sent a letter to the parties in this docket (Docket No. E-01933A-11-0055) and to the parties in the previous TEP rate case docket (Docket No. E-01933A-07-

1 2008 Rate Case other than Staff has objected to the modified performance incentive.

2 Fourth, in the specific circumstances relating to Decision No. 70628, the parties to the
3 2008 Settlement Agreement expressly acknowledged that certain circumstances beyond TEP's
4 control could lead to changes in certain provisions of the Settlement Agreement.⁷

5 **3. Decision No. 70628 adopts "the performance incentive for the DSM adjustor**
6 **mechanism as recommended by Staff in its Direct Rate Design Testimony,"**
7 **which provides TEP the "opportunity to earn up to 10 percent of the**
8 **measured net benefits from the eligible DSM programs, capped at 10 percent**
9 **of the actual program spending." May the Commission adopt a new**
10 **performance incentive that differs from the one adopted in Decision No.**
11 **70628? If so, must the Commission utilize either a new rate case or an ARS §**
12 **40-252 process to reopen Decision No. 70628?**

13 Yes and no, respectively. As set forth above, Joint Respondents believe that the
14 Commission has authority under the EE Rules to adopt a new performance incentive in connection
15 with TEP's new implementation plan outside of a new rate case and without the need to resort to
16 A.R.S. § 40-252.

17 Furthermore, the Joint Respondents believe that the ROO has effectively resolved any
18 concern about this issue. It provides that, in conjunction with its consideration of the Updated
19 Plan, the Commission should reopen Decision No. 70628 pursuant to A.R.S. § 40-252.⁸ In that
20 regard, the ROO noted that TEP had already provided notice to the parties to 2008 Rate Case
21 parties and that none of the 2008 Rate Case parties (other than those that were already intervenors
22 in this docket) took any action.⁹ In addition, the Hearing Division also has sent additional notice
23 to the 2008 Rate Case parties as set described in the ROO.¹⁰ Therefore, there has been redundant
24 notice and opportunity to be heard to fulfill the due process requirements of A.R.S. § 40-252 and

25 0402) ("2008 Rate Case") informing them that TEP was seeking to modify the performance incentive in its
26 2011-2012 Implementation Plan and that the matter might be considered at the February 14-15, 2012 Open
27 Meeting. When the matter was not considered at that time, TEP sent another letter to the same parties on
February 17, 2012 indicating that the matter might be considered at the February 23, 2012 Open Meeting.
Copies of those letters were filed in the dockets.

⁷ See Paragraph 11.1 of the 2008 Settlement Agreement.

⁸ ROO at 30.

⁹ ROO at 30-31.

¹⁰ ROO at 31.

1 to thus allow for a modification of the 2008 performance incentive in conjunction with this docket.

- 2 **4. Paragraphs 20.12 and 20.13 of the settlement agreement approved by Decision**
3 **No. 70628 prohibit the signatories to the settlement agreement from “tak[ing],**
4 **support[ing] or propos[ing] any action that is inconsistent with” the settlement**
5 **agreement, and require them to actively defend the settlement agreement**
6 **before the Commission, courts or other regulatory agencies. Is advocating for**
7 **a change in TEP’s performance incentives consistent with the settling parties’**
8 **obligations under Paragraphs 20.12 and 20.13? Should the ARS § 40-252**
9 **process that is recommended in the ROO be broadened to relieve the parties**
10 **from their obligations under Paragraphs 20.12 and 20.13?**

11 Yes and no, respectively. The Joint Respondents do not believe that support of the
12 Updated Plan violates or is necessarily inconsistent with the 2008 Settlement Agreement. The
13 2008 Settlement Agreement contemplated that there might be changes to the settlement terms due
14 to events beyond TEP’s control.¹¹ The adoption of the EE Rules could be considered such an
15 event.

16 With respect to the second question, the A.R.S. § 40-252 process does not need to be
17 broadened beyond what the ROO and the Hearing Division have already provided. All parties to
18 the 2008 Rate Case (including the settling parties) will have been provided adequate notice and
19 opportunity to be heard on the issue of modifying the 2008 performance incentive. The
20 evidentiary hearing in this docket also provided a full vetting of the new interim performance
21 incentive. Should the Commission adopt the ROO as drafted and approve the Updated Plan, the
22 A.R.S. § 40-252 process underlying the ROO will have implicitly addressed and resolved the
23 second question.

- 24 **5. The rate design advocated by the parties is expected to have a bigger impact**
25 **on TEP’s small businesses customers than its other customers. Is the rate**
26 **design inappropriately discriminatory?**

27 No. The rate design advocated by the Joint Respondents cannot remotely be considered to
be discriminatory (much less “inappropriately discriminatory”) because each Non-Residential
customer is treated equally and experiences a total rate impact from funding TEP’s EE programs

¹¹ 2008 Settlement Agreement, Para. 11.1.

1 that is exactly proportionate to their bills. This is true for the smallest of commercial customers
2 and the largest of mines. Such an approach has been adopted by several other western states,
3 including Idaho, Utah, and New Mexico.¹²

4 Staff has objected to the equal-percentage DSMS proposed by the Joint Respondents and
5 advocates instead for an equal cents-per-kWh DSMS. In its Exceptions to the ROO, Staff argues
6 that the Updated Plan's rate design produces "disproportionately higher rates" on the small
7 commercial rate class. Staff's assertion is incorrect. By definition, the equal percentage rate
8 design adopted in the ROO produces proportionate DSMS rates for all Non-Residential customers,
9 including small commercial customers.

10 Moreover, Staff's contention that the interests of small commercial customers have not
11 been adequately considered by the Joint Respondents is misplaced. The Joint Respondents do not
12 deny that small commercial customers experience a slightly higher percentage incremental bill
13 impact under the Updated Plan than other Non-Residential customers.¹³ Yet, in assessing the
14 percentage bill impact on Non-Residential customers attributable to the DSMS in the Updated
15 Plan, it is important to recognize that all Non-Residential customers end up *equal*. Every Non-
16 Residential customer experiences the same 2.86% *overall* rate impact from the DSMS in the
17 Updated Plan. The fact that the incremental change required to get to an equal percentage bill
18 impact is smaller for larger customers stems from the fact that under the current DSMS these
19 customers are paying a higher percentage of their bill toward EE funding than smaller customers.
20 Thus, it requires a one-time slightly unequal incremental change (across different sized Non-
21 Residential customers) to achieve an equal percentage overall bill impact for funding EE.

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25 ¹² Direct Testimony of Kevin Higgins, Ex. AECC-1 ("Higgins Direct") at 7-8. Wyoming also recovers the
26 costs of EE programs through a percentage rider, but the percentage rate is significantly lower for industrial
customers than for other customers. *Id.*

27 ¹³ Under the Updated Plan, small commercial customers would experience rate increases of 1.71%, while
the increase for industrial customers would be 1.26%, and the increase for large commercial customers
would be 1.60%. Direct Testimony of Denise Smith, Ex. TEP-1 at Ex. DS-1 (Updated Plan, Table 4).

1 Finally, the proposed rate design was discussed extensively during the evidentiary
2 hearing, including Staff's assertion that it was inequitable.¹⁴ The reasonableness of the rate
3 design proposed by the Joint Respondents is affirmed by its proposed adoption in the ROO.¹⁵

4 **CONCLUSION**

5 The Joint Respondents submit that there are no legal impediments to preclude the
6 Commission from approving the Updated Plan as set forth in the ROO. Indeed, the Hearing
7 Division has provided a "belt and suspenders" approach by providing appropriate notice under
8 A.R.S. 40-252 to address any concerns about the modification of Decision No. 70628. No party to
9 the docket, other than Staff, opposes adoption of the Updated Plan. No party to the 2008
10 Settlement Agreement, other than Staff, has raised any objection or concern related to the
11 proposed interim performance incentive or the Updated Plan.

12 Joint Respondents believe that the Commission is legally authorized to approve the
13 Updated Plan as set forth in the ROO and that expeditious approval of the Updated Plan is in the
14 public interest.

15 RESPECTFULLY SUBMITTED this 12th day of October 2012.

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27 ¹⁴ See ROO at 22-24.

¹⁵ ROO at 33-34, 40

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