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5 **BEFORE THE ARIZONA CORPORATION COMMISSION**

6 BOB STUMP, CHAIRMAN
7 GARY PIERCE
8 BRENDA BURNS
BOB BURNS
9 SUSAN BITTER SMITH

Arizona Corporation Commission

DOCKETED

FEB 15 2013

DOCKETED BY 

10 IN THE MATTER OF THE APPLICATION
OF TUCSON ELECTRIC POWER
11 COMPANY FOR THE ESTABLISHMENT OF
JUST AND REASONABLE RATES AND
12 CHARGES DESIGNED TO REALIZE A
REASONABLE RATE OF RETURN ON THE
13 FAIR VALUE OF ITS OPERATIONS
THROUGHOUT THE STATE OF ARIZONA.

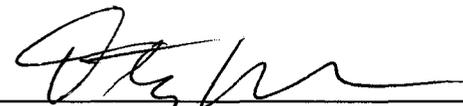
Docket No. E-01933A-12-0291

**NOTICE OF FILING TESTIMONY OF
SOUTHWEST ENERGY EFFICIENCY
PROJECT IN PARTIAL OPPOSITION
TO THE PROPOSED SETTLEMENT
AGREEMENT**

14
15 Southwest Energy Efficiency Project ("SWEEP"), through its undersigned counsel,
16 hereby provides notice that it has this day filed the testimony of Jeff Schlegel in partial
17 opposition to the proposed Settlement Agreement in connection with the above-captioned matter.

18 RESPECTFULLY SUBMITTED this 15th day of February, 2013.

19 ARIZONA CENTER FOR LAW IN
THE PUBLIC INTEREST

20
21 By 
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Project
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25

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8 All Parties of Record

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF
TUCSON ELECTRIC POWER COMPANY FOR
THE ESTABLISHMENT OF JUST AND
REASONABLE RATES AND CHARGES
DESIGNED TO REALIZE A REASONABLE
RATE OF RETURN ON THE FAIR VALUE OF
ITS OPERATIONS THROUGHOUT THE STATE
OF ARIZONA.

DOCKET NO. E-01933A-12-0291

Testimony in Partial Opposition to the Proposed Settlement Agreement of

Jeff Schlegel

Southwest Energy Efficiency Project (SWEEP)

February 15, 2013

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

Docket No. E-01933A-12-0291

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Introduction

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

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

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

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

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

14
15 A. No.

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

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

20
21 A. In my testimony on the Settlement Agreement, I will:

- 22
- 23 ■ State why SWEEP is in partial opposition to the proposed Settlement Agreement.
 - 24 ■ Describe how the Tucson Electric Power Company's 2012 Integrated Resource Plan
25 demonstrates a need for increased energy efficiency resources, and in so doing, address
26 some of the issues raised by Commissioner Pierce in his letter dated February 1, 2013,
27 regarding energy efficiency, Tucson Electric Power Company's (TEP) need for future
28 resources, and the TEP 2012 Integrated Resource Plan.
 - 29 ■ Support the energy efficiency provisions in the Settlement Agreement that would restore
30 energy efficiency programs and ensure that TEP customers receive energy efficiency
31 services to reduce their utility bills, consistent with the resource need documented in the
32 TEP 2012 Integrated Resource Plan.
 - 33 ■ State SWEEP's continued support for energy efficiency program cost recovery using
34 either capitalization or expensing, and comment on some related issues raised in
35 Commissioner Pierce's letter dated February 1, 2013.
 - 36 ■ Summarize how the proposed Settlement Agreement limits the Commission from fully
37 exploring the policy options for addressing utility financial disincentives to energy
38 efficiency, including limiting the Commission's consideration of full revenue
39 decoupling.
 - 40 ■ Describe why full revenue decoupling is a superior option for the treatment of utility
41 financial disincentives to energy efficiency compared to the lost fixed cost revenue
42 recovery mechanism proposed in the Settlement Agreement.

- 1 ▪ Recommend that the Commission substitute full revenue decoupling in place of the lost
2 fixed cost revenue recovery mechanism proposed in the Settlement Agreement because
3 full revenue decoupling more completely and effectively reduces utility company
4 disincentives for the support of activities that eliminate energy waste and reduce utility
5 bills, while lost fixed cost revenue recovery does not.
- 6 ▪ Describe why the Settlement Agreement's proposal to significantly increase the monthly
7 basic service charge is not in the interest of residential customers.

8 **SWEEP's Partial Opposition to the Proposed Settlement Agreement**
9

10 Q. Did SWEEP participate in the settlement negotiations in this rate case?
11

12 A. Yes, SWEEP participated in the settlement negotiations and believes that the settlement
13 process in this rate case was fair, transparent, and inclusive. SWEEP provided input during
14 the settlement negotiations and the input was considered by the other parties.
15

16 Q. What is SWEEP's position on the proposed Settlement Agreement?
17

18 A. SWEEP is in partial opposition to the proposed Settlement Agreement.
19

20 There are some aspects of the Settlement Agreement that SWEEP can support. For instance,
21 SWEEP appreciates that the Settlement Agreement would restore efficiency opportunities
22 that enable customers to reduce their energy bills. As I explained in my direct testimony,
23 energy efficiency programs have strong customer support and are in the public interest
24 because they deliver important and substantial customer, economic, environmental, and
25 utility system benefits.
26

27 SWEEP is in partial opposition to Settlement Agreement because of two provisions:
28

- 29 1. The proposed lost fixed cost revenue recovery mechanism, which inadequately reduces
30 utility disincentives to energy efficiency, and therefore results in fewer opportunities for
31 customers to reduce their energy bills.
32
- 33 2. The significant increase in the residential monthly basic service charge. For a vast
34 majority of customers this increase in the basic service charge will be greater than 40%,
35 which is certainly not gradualism. Also, this increase will limit the ability of customers
36 to maximize savings from energy efficiency.

37 **The Need for Energy Efficiency Resources as Established in TEP's 2012 Integrated**
38 **Resource Plan**
39

40 Q. Have issues and questions been raised regarding the treatment of energy efficiency in Tucson
41 Electric Power Company's (TEP) rate case and the proposed Settlement Agreement, which
42 relate to TEP's need for resources and the TEP 2012 Resource Plan?
43

1 A. Yes. On February 1, 2013, Commissioner Pierce filed a letter in the TEP rate case docket
2 outlining several thoughts related to the treatment of energy efficiency in the TEP rate case
3 and the Preliminary Settlement Term Sheet, upon which the proposed Settlement Agreement
4 is based.

5

6 Q. Please summarize some of the issues that were raised in Commissioner Pierce's letter.

7

8 A. Commissioner Pierce asked whether or not the customer resource needs established in TEP's
9 2012 Integrated Resource Plan (IRP) justified the Company's investment in energy
10 efficiency. In addition, he asked about the proposed Settlement Agreement's Energy
11 Efficiency Resource Plan ("EERP") and whether the EERP circumvents the IRP process.

12

13 Q. According to TEP's 2012 IRP, does TEP need additional energy resources to meet its load
14 obligations?

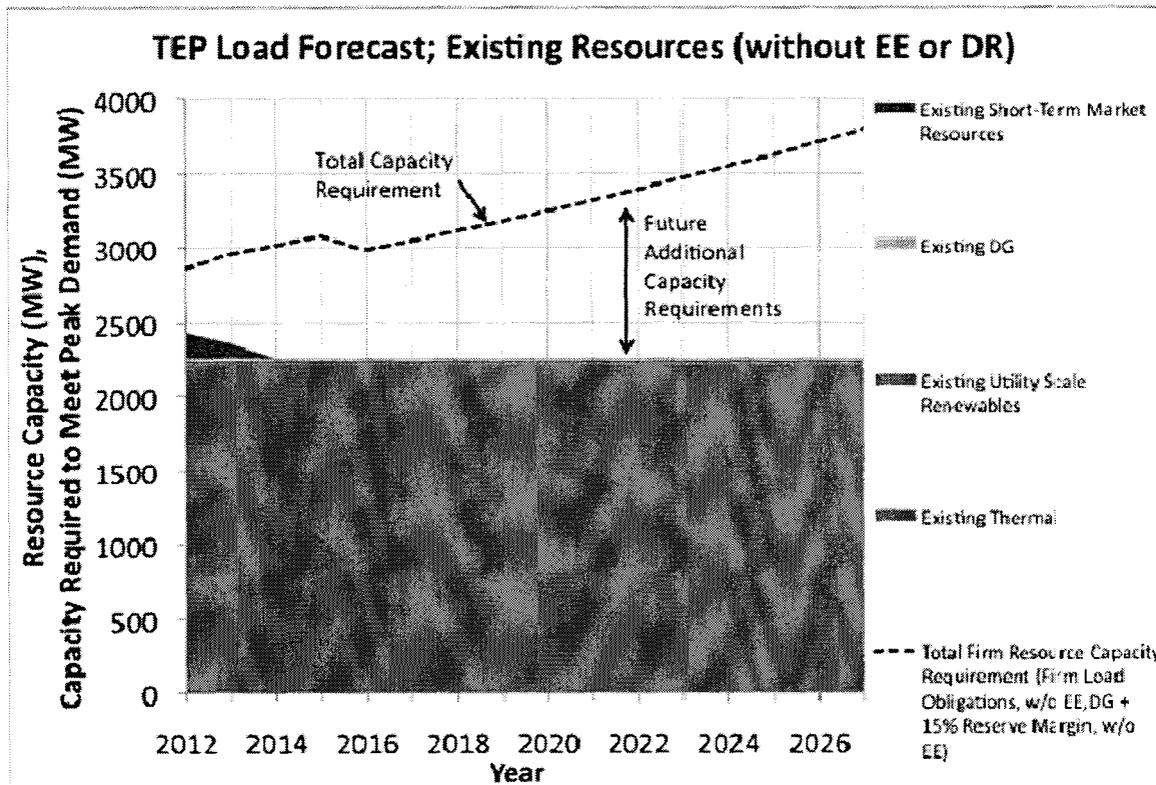
15

16 A. Yes. TEP's 2012 IRP clearly shows that TEP has a shortfall in generation capacity over the
17 coming years.

18

19 Figure SWEEP-1 shows this capacity shortfall in more detail. The black dotted line
20 represents TEP's total capacity requirement (its firm load obligations plus a 15% planning
21 reserve margin), based on the load forecast in TEP's 2012 IRP. The colored regions below
22 the black dotted line show the capacity contributions of TEP's existing generation resources.
23 The gap between the black dotted line and the capacity contributions of TEP's existing
24 generation resources represents the additional capacity that TEP will need in order to fulfill
25 its load obligations and meet customer needs.

1 **Figure SWEEP-1: TEP's 2012 IRP Demonstrates a Capacity Shortfall Over the**
2 **Coming Years**
3



4 Data Sources: TEP 2012 IRP Table 4, Table 5, Table 14, and Chart 16.

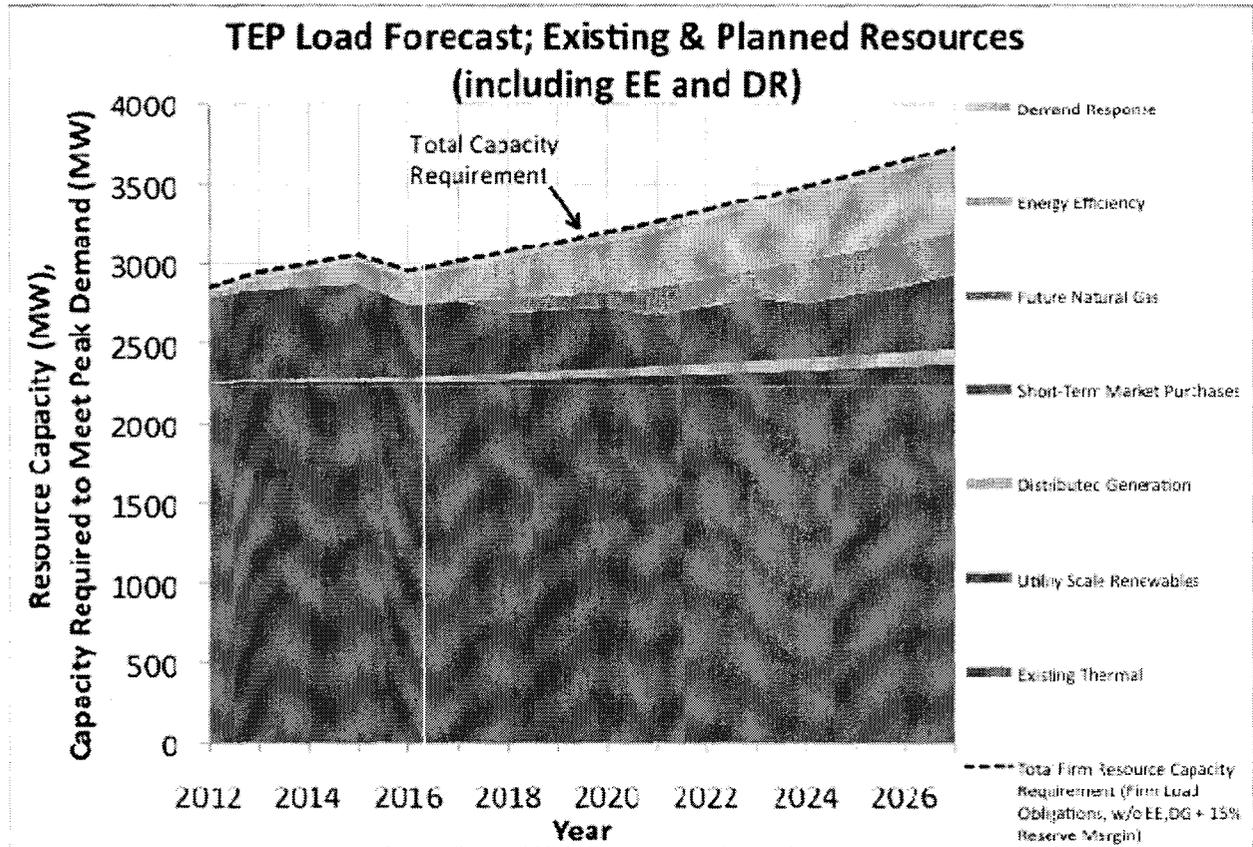
5
6
7 Q. According to its 2012 IRP, how does TEP plan to meet this capacity shortfall?

8
9 A. Because of this capacity shortfall, TEP will need to invest in additional energy resources
10 and/or make additional energy purchases in order to fulfill its load obligations and meet
11 customer needs.

12
13 According to its 2012 IRP, TEP plans to meet this capacity shortfall through a mixed
14 portfolio of resource additions that include: 1) Supply-side generation resources; 2)
15 Distributed generation; and 3) Demand-side energy efficiency resources and demand
16 response, collectively called "Demand Side Management" or "DSM". See Figure SWEEP-2.
17

1
2
3

Figure SWEEP-2: TEP Plans to Meet the Capacity Shortfall Through a Mixed Portfolio of Resources, Including Energy Efficiency

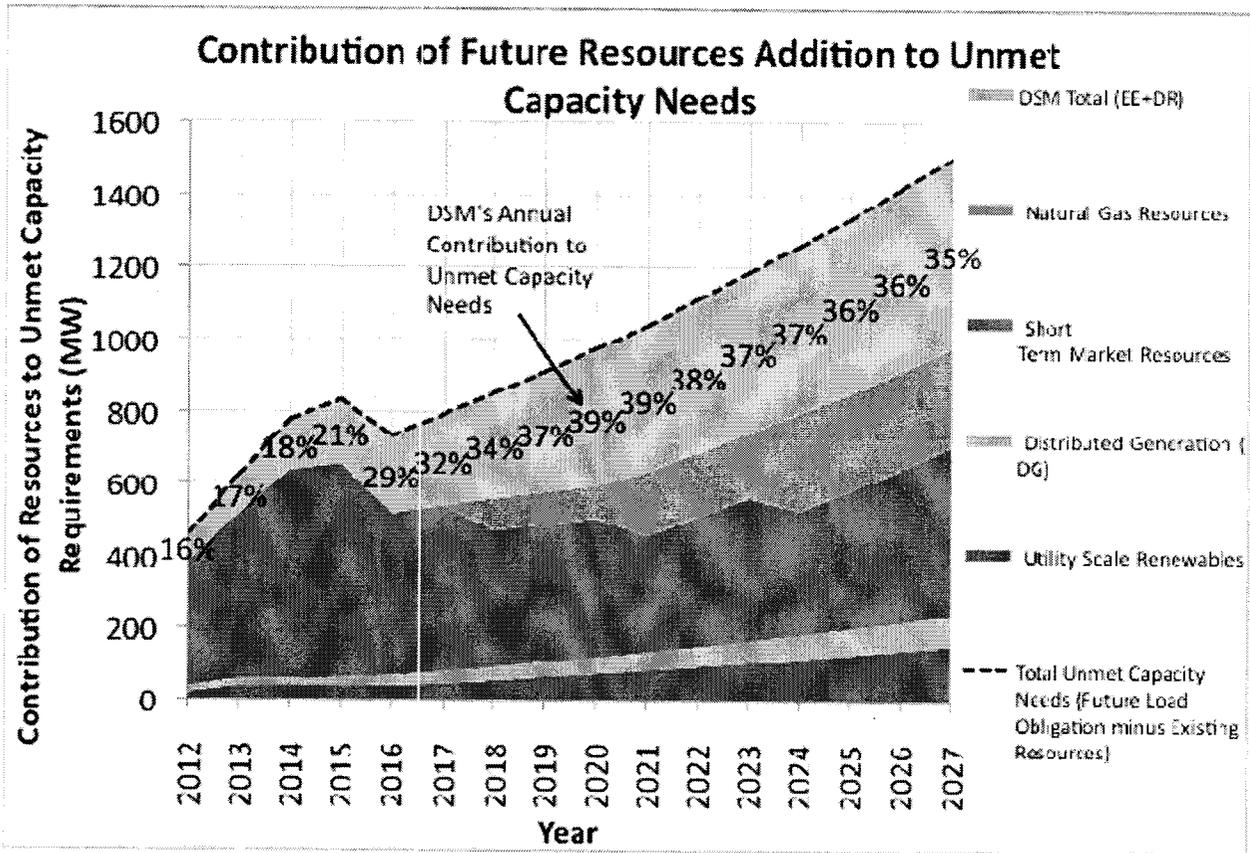


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Data Sources: TEP 2012 IRP Table 4 and Table 5.

- Q. Specifically, how does Demand Side Management, which includes energy efficiency and demand response resources, enable TEP to fulfill its load obligations and make up for its capacity shortfall, according to the TEP 2012 Resource Plan?
- A. Energy efficiency makes a significant contribution toward enabling TEP to fulfill its load obligations and address its capacity shortfall. As shown in Figure 3, during each of the fifteen years in TEP's IRP (2012-2027), Demand Side Management (DSM) programs contribute a major share of TEP's future additional capacity resources to meet capacity needs. Figure SWEEP-3 illustrates the fraction DSM contributes to additional capacity resources to meet the unmet capacity needs in each year over this time horizon. As you can see, DSM contributes over 30% of TEP's future additional capacity resources in most years. In some years, such as 2020, DSM's contribution to TEP's additional capacity resources is as high as 39%.

1 **Figure SWEEP-3: Energy Efficiency Makes a Significant Contribution Toward**
2 **Enabling TEP to Fulfill its Load Obligations**
3

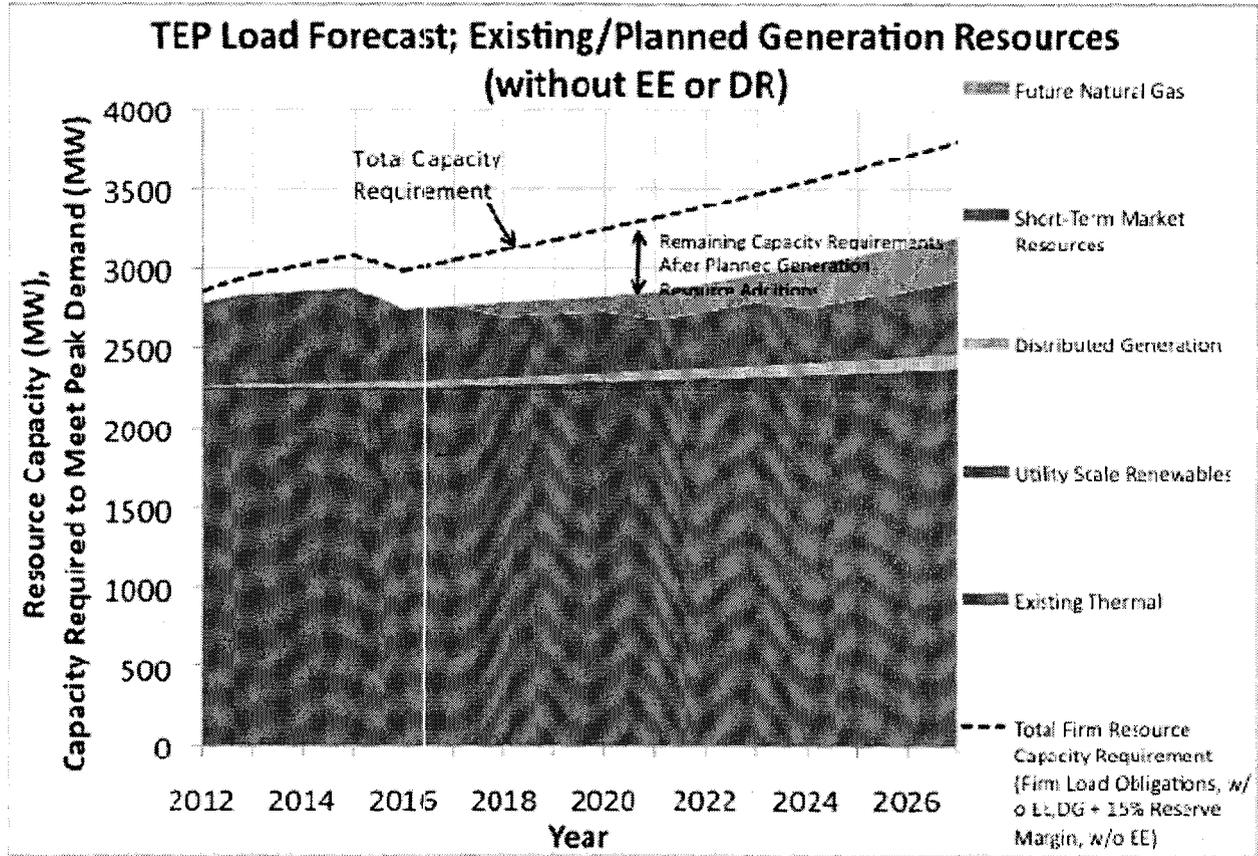


4 Data Sources: TEP 2012 IRP Table 3, Table 4, and Table 5.

5
6
7 Q. What would happen if TEP did not meet this capacity shortfall with energy efficiency?
8

9 A. Without energy efficiency, TEP would have a significant remaining capacity requirement
10 that it would need to meet. This is shown in Figure SWEEP-4. TEP would need to meet this
11 remaining capacity requirement by investing in other energy resources and/or by making
12 additional energy purchases. Unfortunately, these other energy resources are more expensive
13 than energy efficiency and do not compare as favorably from a ratepayer perspective.
14

1 **Figure SWEEP-4: Without Energy Efficiency Investments, TEP Would Have a**
 2 **Significant Remaining Capacity Requirement**
 3



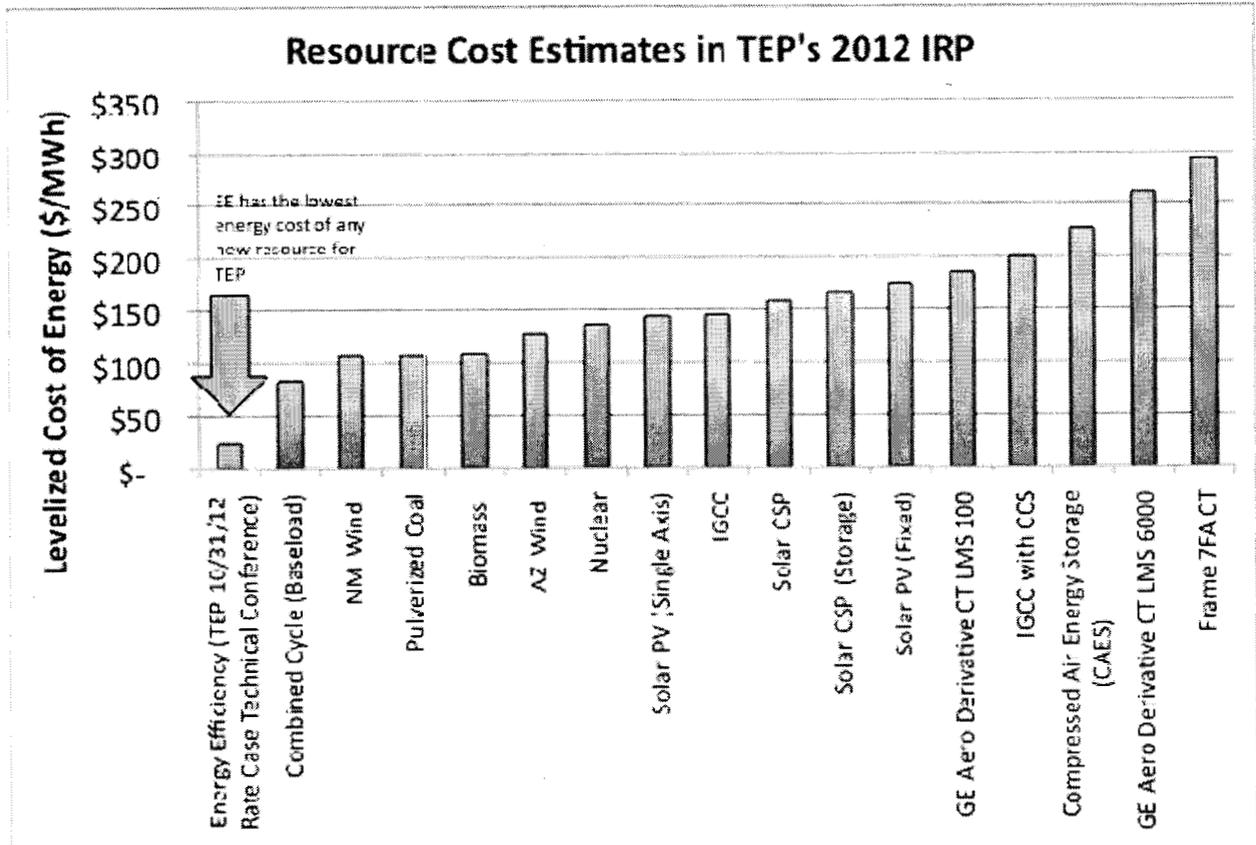
4 Data Sources: TEP 2012 IRP Table 4 and Table 5.

5
 6
 7 Q. From a ratepayer perspective, why is energy efficiency more favorable than other energy
 8 resources?

9
 10 A. From a ratepayer perspective, energy efficiency is the best and lowest-cost energy resource
 11 TEP can use to meet the needs of its customers. As documented in TEP's 2012 IRP and
 12 TEP's rate case technical conferences, cost-effective energy efficiency is the lowest cost,
 13 cleanest, least-risky, and most economy-friendly resource. As shown in Figure SWEEP-5,
 14 investing in other resources would be more costly for ratepayers. Indeed, TEP estimates its
 15 cost for energy efficiency over the 2012-2020 time horizon to be \$23/MWh.¹ Notably, the
 16 next most affordable energy resource costs \$83/MWh, which is significantly (more than 3.5
 17 times) more expensive than energy efficiency.

¹ See TEP's October 31, 2012 Rate Case Technical Conference presentation on its Energy Efficiency Resource Plan, which corrected the cost of energy efficiency in TEP's 2012 IRP.

1 **Figure SWEEP-5: Energy Efficiency is the Least Expensive Energy Resource Available**
2 **to Meet Customer Needs**
3

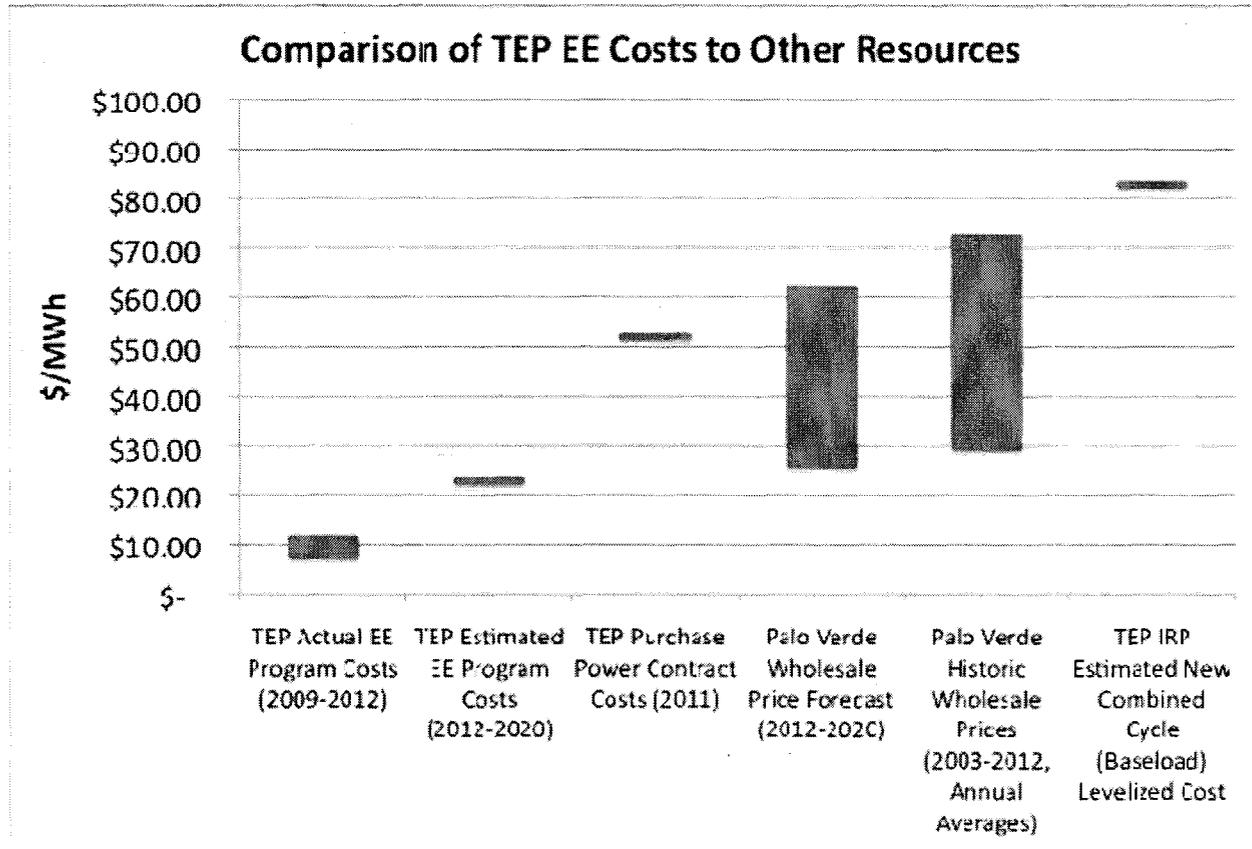


4 Data Sources: TEP 2012 IRP Chapter 6; TEP Rate Case Technical Conference, EERP, 10/31/2012.

5
6
7 Q. Does energy efficiency also compare favorably to power purchases?

8
9 A. Yes. According to TEP's 2012 IRP and information provided in TEP's rate case technical
10 conferences, new and implemented cost effective energy efficiency costs less than merchant
11 power purchases both in recent years and in forecasts over the next decade. See Figure
12 SWEEP-6.
13

1 **Figure SWEEP-6: New and Implemented Energy Efficiency Costs Less than New and**
2 **Forecasted Power Purchases Over the Next Decade**
3



4 Data Sources: TEP Rate Case Technical Conference, EERP, 10/31/2012; TEP DSM Program Progress Reports
5 2009-2012; TEP 2012 IRP filing for Historical Year 2011, Item B.1.i; TEP 2012 IRP, Chart 62 and page 96;
6 and U.S. Energy Information Administration Wholesale Market Data.
7
8

9 Q. How does the level of energy efficiency proposed in the Settlement Agreement compare to
10 the resource need and level of energy efficiency documented in the TEP 2012 IRP?
11

12 A. The level of energy efficiency proposed in the Settlement Agreement is lower than the level
13 of energy efficiency documented in the TEP 2012 IRP.
14

15 Q. In your opinion does the TEP EERP and the level of energy efficiency proposed in the
16 Settlement Agreement circumvent the IRP process?
17

18 A. No. The data from the TEP 2012 IRP, which I have presented in summary above, clearly
19 demonstrate that there is no "short-circuit in the IRP process." The need to invest in energy
20 efficiency is completely justified based on TEP's actual customer needs as established in
21 TEP's 2012 IRP – which is precisely what should happen, as Commissioner Pierce indicated
22 in his letter.
23

24 If anything, TEP should be planning to achieve more energy efficiency than has been
25 proposed in the Settlement Agreement based on the resource needs identified in the TEP IRP.

1 If TEP under-invests in the energy efficiency documented in the 2012 IRP, and then has to
2 add other resources to substitute for the energy efficiency resources identified in the TEP
3 IRP, the total costs for TEP customers will be significantly higher.

4 **Energy Efficiency Cost Recovery and the EERP**
5

6 Q. What cost-recovery options are generally available to electric utilities for investing in energy
7 efficiency resources and paying for a portion of the upfront cost of energy efficiency
8 programs?²
9

10 A. As I discussed in my direct testimony, energy efficiency programs produce long-term energy
11 savings to customers but require some upfront costs for program implementation. Investor
12 owned utilities, like TEP, generally have two ways to pay for these upfront costs. One way is
13 to include the program costs in the company's annual operating expenses; the second option
14 is to amortize program costs, whereby the upfront costs are paid off over time (plus interest),
15 much like a mortgage on a home. This second option would treat energy efficiency as an
16 amortized investment, conceptually similar to an investment in other energy resources, and
17 would include a Commission-authorized rate of return or a mechanism to recover the
18 carrying costs.
19

20 As noted in my direct testimony, in concept SWEEP can support either cost recovery
21 mechanism.
22

23 Q. Which of these two cost-recovery options does the Settlement Agreement propose for
24 recovering energy efficiency program costs as part of its Energy Efficiency Resource Plan
25 (EERP) proposal?
26

27 A. The Settlement Agreement proposes the second option of amortizing energy efficiency
28 program costs as a regulatory asset and recovering those costs over five years through TEP's
29 Demand Side Management Surcharge (DSMS) rather than in its base rate. This amortization
30 proposal for the EERP is not ratebasing and is not identical to how traditional generation
31 resources are treated. Instead, the EERP would amortize and recover the energy efficiency
32 programs costs over a five-year period using a regulatory asset.
33

34 Q. Why is the cost recovery for energy efficiency programs different than the treatment of a
35 traditional generation investment?
36

37 A. There are two main fundamental differences regarding energy efficiency when compared to
38 other resources. First, the utility does not own the energy efficiency assets; they are owned
39 by customers (and therefore there is not a return to the utility on a utility-owned or investor-
40 owned capital investment). Second, there needs to be timely (generally annual) recovery of
41 utility program costs, because the utility perceives there may be some regulatory risk
42 associated with program cost recovery, yet the utility does not have the business opportunity
43 to earn a return on the utility's investment in an asset that the utility owns. Timely and

² Participating customers who install energy efficiency pay for a portion of the costs.

1 transparent cost recovery helps to ensure that the utility funds energy efficiency to benefit its
2 customers, with less utility bias against energy efficiency resources.
3

4 Q. Does treatment of energy efficiency cost recovery through amortization lead to a big financial
5 incentive for the Company to invest in energy efficiency?
6

7 A. No. TEP under the EERP does not have a large or significant financial incentive to invest
8 more in energy efficiency, and TEP would not be receiving any financial windfall for
9 funding energy efficiency. Essentially, TEP would be recovering the carrying costs of the
10 regulatory asset, and nothing more.
11

12 In fact, given the structure of the EERP per the Settlement Agreement, TEP is facing
13 significant risks regarding energy efficiency program cost recovery, yet TEP does not have
14 an opportunity, beyond recovering the carrying costs, for a financial incentive or increased
15 earnings.

16 **Addressing Utility Financial Disincentives to Energy Efficiency and Preserving the**
17 **Commission's Ability to Consider Options and Decide Energy Policy**
18

19 Q. How does the proposed Settlement Agreement offer to address utility financial disincentives
20 to energy efficiency?
21

22 A. The Settlement Agreement proposes to implement a lost fixed cost revenue (LFCR) recovery
23 mechanism. This mechanism would recover a portion of the distribution and transmission
24 costs associated with the pursuit of energy efficiency and distributed generation by
25 residential, commercial, and industrial customers. The Settlement Agreement would also
26 allow residential customers to "opt out" of this LFCR mechanism by accepting higher fixed
27 charges through an increased basic service charge.
28

29 Q. Does the proposed Settlement Agreement limit the Commission from fully considering the
30 policy options for addressing utility financial disincentives to energy efficiency?
31

32 A. Yes. By offering only one option for addressing utility financial disincentives to energy
33 efficiency (i.e., the LFCR mechanism), the proposed Settlement Agreement limits the
34 Commission from fully exploring and vetting the various policy options it could consider,
35 including full revenue decoupling. Indeed, in any adoption of the full Settlement as filed, the
36 Commission would not be able to consider full revenue decoupling at all. Instead, it would
37 have to consider this option *entirely outside* of the Agreement. Accordingly, the proposed
38 Settlement limits the Commission's ability to direct energy policy related to the treatment of
39 utility financial disincentives to energy efficiency.
40

41 Q. Why is full revenue decoupling a policy option worthy of Commission consideration?
42

43 A. As I testified in my direct testimony, the financial interest of TEP should be better aligned
44 with the interests of its customers by reducing financial disincentives to utility support of
45 energy efficiency, thereby resulting in more energy savings, total lower costs for customers,

1 and larger customer energy bill reductions.
2

3 Full revenue decoupling completely and effectively reduces utility company disincentives for
4 the support of activities that eliminate energy waste. As such, full revenue decoupling is
5 important not only for full, enthusiastic utility support of energy efficiency programs but also
6 for activities that reduce sales but are not or may not be directly linked to the Company's
7 portfolio of energy efficiency programs. This could include utility support for building
8 energy codes; appliance standards; energy education and marketing; state and local
9 government energy conservation efforts; and federal energy policies.

10
11 Q. Why is full revenue decoupling a superior option for the treatment of utility financial
12 disincentives to energy efficiency than the proposed LFCR mechanism?
13

14 The proposed LFCR mechanism inadequately reduces utility disincentives to energy
15 efficiency, and therefore results in fewer opportunities for customers to reduce their energy
16 bills. Consequently, it discourages TEP support of building energy codes, appliance
17 efficiency standards, and state initiatives and legislation. It will also likely result in
18 contentious and protracted technical proceedings at the Commission (as has been the
19 experience in lost revenue recovery mechanism proceedings in other states). Finally, the
20 LFCR mechanism represents an automatic rate increase. In contrast, because full revenue
21 decoupling allows for rate adjustments in both a positive and negative direction, decoupling
22 could result in either a credit or a charge on the customer bill.
23

24 LFCR does nothing to reduce TEP's financial incentive to encourage customers to use more
25 electricity – and the more customers waste energy, the more TEP revenues and earnings
26 increase. Also, under LFCR in the Agreement, as the Arizona economy recovers and electric
27 demand increases, TEP revenues and earnings would also increase. Specifically, TEP could
28 retain all revenues higher than the revenue levels established by the Agreement, which would
29 result in higher earnings. TEP would also retain all revenues higher than the revenue levels
30 established by the Agreement from increased electrification and electric vehicles. In contrast,
31 full decoupling would provide a credit to customers for any revenues higher than authorized
32 revenues (determined as authorized revenue per customer multiplied by the number of
33 customers).
34

35 Q. Does the proposed residential opt-out rate serve the interest of customers who want to reduce
36 their energy bills?
37

38 A. No. The residential opt-out rate requires customers to accept higher fixed charges through an
39 increased basic service charge. As I testified in my rate design direct testimony, and as I
40 testify below, SWEEP does not support increasing the basic service charge as a mechanism
41 to recover additional fixed costs. Increasing the basic service charge mutes the price signal to
42 customers by reducing the amount of utility bill cost savings that customers experience when
43 they conserve energy or increase their energy efficiency.
44

45 Q. What action should the Commission take on the Settlement Agreement regarding LFCR and
46 decoupling?

- 1
2 A. The Commission should reject the LFCR mechanism in the Settlement Agreement and
3 require the Company to file a proposal for full revenue decoupling.

4 **Increasing the Basic Service Charge is Not in the Interest of Customers**

- 5
6 Q. How does the Settlement Agreement propose to change TEP's current basic service charge
7 for residential customers?
8
9 A. In general, the Settlement Agreement proposes to increase TEP's current basic service charge
10 from \$7.00-\$8.00 per month³ to \$10.00-\$11.50 per month.
11
12 Q. Is this a significant increase for residential customers?
13
14 A. Yes. For a vast majority of customers this increase in the basic service charge will be greater
15 than 40% and sometimes much greater than 40% as compared with current levels. The
16 extent of this increase is certainly not consistent with the important principle of gradualism.
17 And unlike an increase in the energy portion of the utility bill, customers will not be able to
18 take action to reduce or mitigate this increased cost.
19
20 Q. What portion of the total rate increase for residential customers is due to the increase in the
21 basic service charge?
22
23 A. The Settlement Agreement states that Residential R-01 customers will see an increase in their
24 average annual bill of \$34.92. Yet the basic service charge for R-01 customers increases by
25 \$3 per month (from \$7 to \$10 per month). Simple arithmetic would indicate that the increase
26 in the basic service charge is on the order of \$36 per year and is therefore a substantial driver
27 of the total rate increase.⁴ Notably, this charge is one that customers cannot mitigate or
28 reduce through their actions.
29
30 Q. Is increasing the basic service charge in the interest of customers?
31
32 A. No, higher basic service charges are not in the public interest and are not in the interest of
33 customers. As I described in my rate design testimony, SWEEP believes it is important for
34 customers to be able to maximize savings from energy efficiency, and a higher monthly
35 service charge limits that ability. Increasing the basic service charge mutes the price signal to
36 customers by reducing the amount of utility bill cost savings that customers experience when
37 they conserve energy or become more energy efficient. A higher basic service charge also
38 reduces the customer incentive to engage in energy efficiency opportunities because
39 customers can affect only a smaller portion of their total utility bills. Monthly basic service

³ Tucson Electric Power, Direct Testimony of Craig A. Jones, 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, June 15, 2012, at page 32.

⁴ Part of the increase in the basic service charge appears to be offset by reductions in other areas of the customer's bill, leading to a total annual increase that is less than \$36.

1 charges also have a tendency to fall disproportionately on smaller customers – who can often
2 least afford them.

3 **Conclusion**

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Q. Does this conclude your testimony?

A. Yes.