BEFORE THE NEW MEXICO PUBLIC REGULATION COMMISSION

IN THE MATTER OF THE APPLICATION OF PUBLIC SERVICE COMPANY OF NEW MEXICO FOR APPROVAL OF ELECTRIC ENERGY EFFICIENCY PROGRAMS AND PROGRAM COST TARIFF RIDER PURSUANT TO THE NEW MEXICO PUBLIC UTILITY AND EFFICIENT USE OF ENERGY ACTS	)	**Case No. 12-00317-UT**
PUBLIC SERVICE COMPANY OF NEW MEXICO,	)	
Applicant.	)	

DIRECT TESTIMONY

OF

GERARD T. ORTIZ

October 5, 2012

DIRECT TESTIMONY OF
GERARD T. ORTIZ
CASE NO. 12-00317-UT

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is Gerard T. Ortiz. I am the Vice President of Regulatory Affairs for Public Service Company of New Mexico ("PNM" or "Company"). My business address is Public Service Company of New Mexico, Main Offices, MS-1105, Albuquerque, New Mexico 87158.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL QUALIFICATIONS.

A. I graduated from New Mexico State University in 1981 with a Bachelor of Science degree in Electrical Engineering. I obtained a Master of Business Administration degree, with a concentration in Finance, from the Robert O. Anderson Graduate School of Management at the University of New Mexico in 1988. I am a Registered Professional Engineer in the State of New Mexico (Registration No. 9687). Since 1981, I have been employed by PNM, and have held a variety of engineering, supervisory, and managerial positions in Distribution Engineering, Electric Marketing, Business Planning, and Market Services in addition to my current assignment. I was promoted to my current position in August, 2012. A statement of my experience and qualifications, including a list of the New Mexico Public Regulation Commission ("NMPRC" or "Commission") proceedings in which I have either testified or filed testimony, is attached as Exhibit GTO-1.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

A. PNM's Application in this case requests approval of its 2012 Energy Efficiency and Load Management Program Plan ("2012 Plan") and associated tariff rider under which PNM will recover its costs of implementing the 2012 Plan together with a profit incentive in accordance with the Efficient Use of Energy Act ("EUEA") and the Public Utility Act ("PUA"). My testimony:

1. introduces PNM's other witnesses in this case who are presenting direct testimony;
2. summarizes PNM's Application;
3. summarizes the goals of the energy efficiency programs and progress towards those goals;
4. demonstrates why the proposed profit incentive should be approved; and
5. briefly describes the revised rider and its elements.

Q. WHO ARE PNM'S OTHER WITNESSES WHO ARE PROVIDING DIRECT TESTIMONY IN THIS CASE?

A. Mr. Steven M. Bean, PNM's Manager, Energy Efficiency Design, will describe PNM's 2012 Plan and the public advisory process PNM implemented to assist in developing the 2012 Plan. Mr. Bean will describe the proposed changes to PNM's existing electric energy efficiency programs and the new programs being proposed. In so doing, Mr. Bean will discuss the costs associated with the 2012 Plan, forecasted customer participation rates, total resource cost ("TRC") calculations, targeted customer segments and the measurement and verification ("M&V") process. Mr.

Bean will also describe the proposed tariff rider and the derivation of the rate elements contained in the rider, including the profit incentive component.

Mr. Patrick J. O'Connell, PNM's Director, Planning and Resources, explains the methodology used to determine the energy efficiency avoided costs used in the TRC calculations to demonstrate the cost-effectiveness of each of the programs proposed in the 2012 Plan and which are also used to determine an appropriate profit incentive.

Mr. Frank M. Graves, Principal and co-leader of the utility practice group at the Brattle Group, discusses the economic and policy justification for profit incentives, explores how other states have implemented profit incentives for energy efficiency, describes a methodology for deriving a reasonable profit incentive consistent with the directives of the EUEA, and proposes a reasonable profit incentive for PNM.

Q. PLEASE SUMMARIZE PNM'S APPLICATION IN THIS CASE.

A. PNM is seeking Commission approval of its 2012 Plan and associated tariff rider designed to recover the costs of implementing the 2012 Plan together with a reasonable profit incentive in accordance with the EUEA and the PUA. The 2012 Plan presents updated participation targets and budgets for existing programs approved by the Commission in Case No. 10-00280-UT, proposed modifications of existing programs and five new programs. PNM witness Bean describes the programs proposed in the 2012 Plan.

All programs proposed pass the TRC test for cost-effectiveness. In selecting the programs, PNM also carefully considered public comments and suggestions. As a result of the public advisory process described by Mr. Bean, PNM believes that there is general agreement among members of the public advisory group regarding the reasonableness of the program changes and new programs being proposed. The set of programs is designed to provide broad participation opportunities among rate classes to which the Rider will apply. PNM developed the portfolio of programs to appeal to various segments of residential customers, including low-income customers. The 2012 Plan includes low-cost and no-cost programs to achieve broad participation among all residential customers. In addition, every commercial or industrial customer who pays the energy efficiency rider is eligible to participate in the programs for non-residential customers. The 2012 Plan proposes to recover program costs in the amount of the proposed total annual budget of $22,493,227 plus a profit incentive in the amount of $4,205,656 million through a tariff rider, PNM Rider No. 16. In PNM's view, the proposed incentive is a critical component of the 2012 Plan. The 2012 Plan has projected annual energy savings of approximately 82.5 gigawatt-hours ("GWh") per year and demand savings of about 76 megawatts ("MW"). The 2012 Plan is cost effective, with a TRC score of 1.70 for the portfolio. As testified to by PNM witness O'Connell, the value of deferred capacity costs due to the energy efficiency programs is calculated to be $124.04 per kilowatt-year.

Q. ARE THERE MINIMUM ENERGY SAVINGS REQUIREMENTS THAT PNM MUST MEET?

A. The EUEA requires utilities to achieve certain levels of energy efficiency savings in 2014 and 2020. In calendar year 2014, savings must be at least five percent of 2005 total retail kilowatt-hour ("kWh") sales to New Mexico customers and increasing to ten percent in 2020 as a result of energy efficiency and load management programs implemented starting in 2007. PNM's total retail sales in 2005 were 8,224 GWh. Therefore, the minimum savings requirements are 411 GWh in 2014 and 822 GWh in 2020.

Q. WHAT PROGRESS HAS PNM MADE TOWARD ACHIEVING THE MINIMUM SAVINGS REQUIREMENT?

A. PNM reported the following savings in its Energy Efficiency Program Annual Reports: 35.2 GWh in 2008; 39.9 GWh in 2009; 58.8 GWh in 2010; and 57.6 GWh in 2011. The average lifetimes of the savings reported were 8.6 years in 2008; 8.9 years in 2009; 9.0 years in 2010; and 8.5 years in 2011. Therefore, the savings from those years will count toward achievement of the minimum requirement in 2014. The cumulative sum of the savings in 2008 through 2011 is 192 GWh. PNM estimates that an additional 63 GWh of savings will be achieved in 2012. Therefore, the total cumulative savings applicable to the minimum requirement of 411 GWh will be about 255 GWh, or about 62 percent of the goal, by the end of calendar year 2012. PNM anticipates meeting the statutory energy savings required in 2014 if the Commission approves the 2012 Plan as presented.

Q. HOW WILL THE PROJECTED ANNUAL SAVINGS UNDER THE 2012 PLAN POSITION PNM FOR ACHIEVING THE 2014 MINIMUM REQUIREMENT?

A. The 2012 Plan projects 82.5 GWH of savings per year after implementation of the proposed new programs. PNM projects that about 74 GWh will be achieved in calendar year 2013, assuming the 2012 Plan is approved by April 1, 2013, and that PNM can launch the new programs before the summer season begins. PNM projects that savings would be approximately 82.5 GWh in calendar year 2014, the first full year of implementation of the 2012 Plan. Cumulative savings through 2014 would then total approximately 411 GWh. Table 1 shows the actual savings and program costs for calendar years 2008 through 2011 and the projected savings and program costs for calendar years 2012 through 2014.

Table 1

	2008	2009	2010	2011	2012	2013	2014
Energy Savings (GWh)	35.2	39.9	58.8	57.6	63.4	74.0	82.5
Cumulative Savings (GWh)	35	75	134	192	255	329	411
Lifetime Savings (GWH)	302	352	529	491	540	577	643
Demand Savings (MW)	7.5	6.3	9.9	9.7	10.8	14.3	16.0
Load Management (MW)	47.4	53.4	67.0	56.9	56.0	58.0	60.0
Program Cost ($M)	$ 8.0	$ 12.0	$ 16.6	$ 16.6	$ 17.5	$ 20.3	$ 22.5

Q. WILL IMPLEMENTATION OF THE 2012 PLAN ENABLE PNM TO ACHIEVE THE MINIMUM EUEA GOAL FOR 2014?

A. PNM projects that it will achieve the EUEA goals assuming that the 2012 Plan is approved by April 1, 2013 so that new programs can be launched in May 2013 and that PNM's projections for customer participation are achieved or exceeded in 2013 and 2014. Savings under several of the new programs PNM is proposing in the 2012 Plan are primarily achieved in the summer season; therefore, it is critical that programs are implemented in time to affect summer usage in 2013 in order for PNM to achieve the minimum EUEA savings levels for 2014. Timely approval of the 2012 Plan will also allow PNM to end two existing programs that PNM projects will no longer be cost-effective without expending additional funds.

Q. WHAT ARE THE PRIMARY FINANCIAL CONCERNS OF PROVIDING ENERGY EFFICIENCY PROGRAMS FROM A UTILITY'S PERSPECTIVE?

A. The traditional electric utility business model seeks to provide adequate and reliable power to meet customer demand. It involves building generation plant, transmission lines, transformers, substations, distribution lines and other plant and facilities necessary to accomplish this objective. This involves heavy capital investment, making the traditional electric utility business model "capital intensive". Under traditional regulation, utilities make money by selling the power they generate at rates sufficient to cover their costs and earn a return on the capital invested in the property used to serve customers. The rates are designed in such a manner that the more electricity sold by the utility, the more money it makes and the more plant and facilities it builds to meet customer demand, the greater are the profits it earns. Energy efficiency programs are in direct conflict with this traditional utility business and regulatory model. Utilities are now being asked to spend money on programs that require little to no capital investment and that result in selling less of their product, which reduces the amount of money they can earn to recover their fixed costs and reduces the overall profitability and profit potential of the traditional business. In short, there are three primary financial concerns: (1) energy efficiency program costs must be recovered; (2) reduced sales reduces revenues and profits, i.e. the "through-put incentive"; and (3) money spent on energy efficiency programs does not provide a return as does the capital investment in utility property that is used to meet customer demand for electricity. Therefore, there must be a framework that appropriately addresses all three financial concerns so that an effective regulatory environment promoting energy efficiency exists.

Q. DOES THE EUEA IN NEW MEXICO ADDRESS ALL THREE OF THE FINANCIAL CONCERNS YOU DESCRIBE?

A. Yes. The EUEA requires all three to be appropriately addressed. First, the Commission approves program plans, such as the 2012 Plan, to determine if the programs meet the TRC test and therefore are determined to be cost-effective. Utilities are then allowed to recover the program costs through base rates, a tariff rider, or a combination of the two, at the utility's option. Second, the EUEA requires the Commission to identify regulatory disincentives to energy efficiency and take steps to remove them in a manner that balances the interests of customers and investors and the overall public interest. Third, the EUEA requires the Commission to provide utilities with "an opportunity to earn a profit on cost-effective energy efficiency and load management resource development that, with satisfactory program performance, is financially more attractive to the utility than supply-side utility resources." The EUEA also requires that recovery of the profit incentive shall be through base rates, a tariff rider, or a combination of the two, at the utility's option.

Q. DOES PNM'S APPLICATION ADDRESS ALL THREE FINANCIAL CONCERNS?

A. PNM's Application addresses the first and third financial concerns and chooses that recovery of program costs and the profit incentive be accomplished through a tariff rider. PNM stipulated in Case No. 10-00086-UT that the rates approved in that case addressed the second financial concern and that PNM would not seek any additional ratemaking mechanism to address the "disincentives", or "through-put incentive", until its next general rate case, after good faith consultations regarding alternative ratemaking solutions.

Q. PLEASE ELABORATE ON YOUR EARLIER STATEMENT THAT THE PROPOSED INCENTIVE IS A CRITICAL COMPONENT OF PNM'S APPLICATION.

A. PNM has developed and offered cost-effective energy efficiency programs for the last several years that have put PNM on pace to achieve the 2014 energy saving goal identified in the EUEA. These programs have reduced participating customers' bills and have provided system benefits in terms of avoided fuel and capacity costs to all of our customers. These benefits will continue into the future. Yet, as I explained earlier, these savings will result in reduced additions to rate base and in turn reduced shareholder returns. That being the case, approval of a meaningful incentive that fairly balances customer and investor interests (and the overall public interest) as required by the EUEA is essential.

Q. WITH WHAT RATEMAKING STANDARDS MUST PNM'S TARIFF RIDER COMPLY?

A. It is my understanding that all rates must be "just and reasonable" and that would include energy efficiency rates. A rate is "just and reasonable" if it falls within a "zone of reasonableness" which balances the interests of customers and investors. These general ratemaking requirements were recently confirmed by the New Mexico Supreme Court to be applicable to energy efficiency rates in *Attorney General v. New Mexico Public Regulation Commission,* 2011-NMSC-034, 150 N.M. 174, 258 P.3d 453. It is also my understanding that the rates must comply with any ratemaking directives contained in the EUEA that may be in addition to the general ratemaking requirements I have described. In my opinion, PNM's Rider No. 16 is just and reasonable and meets the requirements of the EUEA.

Q. WHAT METHODS HAS THE COMMISSION TRADITIONALLY USED TO DETERMINE IF RATES ARE JUST AND REASONABLE?

A. First, the Commission determines the revenue requirements associated with the business activity for which rates are being set. To determine the revenue requirements associated with the business activity for which rates are being set, the Commission ascertains the reasonable and prudently-incurred costs plus an appropriate profit margin to determine the amount of revenues that should be recovered. Because a utility's traditional business is capital-intensive, a return on investment (also called rate base) is generally considered to be the most appropriate way to derive the appropriate amount of profit included in a just and reasonable rate. The amount of profit is determined by the return on equity component of the return on rate base. PNM witness Graves describes generally how a reasonable return on equity is derived.

Q. IS THIS TRADITIONAL APPROACH USED BY PNM IN DEVELOPING ITS PROPOSED PROFIT INCENTIVE?

A. For the most part, yes. The revenue requirements associated with the 2012 Plan are determined in much the same way, i.e. the costs associated with the 2012 Plan are determined, in fact approved in advance, by the Commission, and then a reasonable profit margin is added. However, because energy efficiency programs have little to no capital investment associated with them, there is no rate base by which a reasonable profit can be calculated. Thus, as described more fully by Mr. Graves, pragmatic adjustments to the traditional ratemaking formula must be used to derive a just and reasonable rate that meets the requirements of the EUEA to provide a profit incentive for cost-effective energy efficiency programs that is more financially attractive than supply-side resources. This is due to the financial and economic characteristics associated with the energy efficiency business, i.e. the traditional ratemaking formula must be adjusted to provide an alternative profitability measure to the traditional return on equity since there is no rate base upon which a return may be granted. As described in more detail by Mr. Graves, the alternative profitability measure proposed by PNM is based on the foregone return on equity associated with avoided capacity savings projected to result from the 2012 Plan.

Q. HOW HAS THE COMMISSION DETERMINED THE APPROPRIATE AMOUNT OF PROFIT IN PAST CASES?

A. In Case No. 10-00280-UT, the Commission provided an incentive adder on top of the program costs. Accepting Staff's proposal for purposes of that case, the Commission approved a profit margin that it calculated at 7.7%, finding that the amount was appropriate due to the reduced riskiness of recovery of the energy efficiency program costs through a tariff rider. But the Commission emphasized that there was not enough experience yet to determine the best approach to developing incentives and indicated that it would explore other approaches in future cases.

Q. DO YOU AGREE THAT THE APPROACH USED BY THE COMMISSION IN CASE NO. 10-00280-UT IS THE BEST METHOD TO DEVELOP INCENTIVES?

A. No, I do not. PNM witness Graves describes the various approaches being used in other states and, drawing upon the best features of these methods, derives a profit incentive consistent with the directives contained in the EUEA and comparable to incentives being provided in other states. Mr. Graves explains why basing the amount of the incentive on the relative riskiness of collecting energy efficiency program costs is inappropriate.

Q. WHY SHOULD PNM EARN A PROFIT ABOVE THE COSTS OF IMPLEMENTING ENERGY EFFICIENCY PROGRAMS IF IT HAS NOT INVESTED ITS OWN MONEY IN THE PROGRAMS?

A. First, just because PNM recovers the costs of the energy efficiency programs in a timely manner due to the use of a tariff rider does not mean that PNM is not using its own funds to implement the programs. Rates are designed to recover those costs and customers are paying for the services provided by PNM in implementing the programs. Second, the EUEA expressly states that a profit should be allowed on cost-effective energy efficiency and load management resource development, not just the programs in which the utility has invested capital. Forcing the utility to invest capital in energy efficiency programs in order to receive the profit required by the EUEA could result in uneconomic resource development decisions by the utility, possibly resulting in failure to identify and implement cost-effective programs which do not require the investment of capital. As a practical matter, PNM has not identified any energy efficiency or load management programs that would be cost-effective, or more cost-effective, if PNM were to have invested capital in them. Only permitting a utility to earn a profit on programs that involve capital investment would nullify critical provisions of the EUEA.

Q. BUT IS IT FAIR TO CUSTOMERS TO REQUIRE THEM TO PAY FOR A PROFIT INCENTIVE WHEN INVESTORS HAVE NOT RISKED THEIR CAPITAL IN THE VENTURE?

A. As discussed more fully by Mr. Graves, the risks associated with energy efficiency programs are not limited to the risk associated with recovery of the costs of implementing the programs. Investors have invested their capital in the business as a whole—the primary business being building distribution and transmission lines, transformers, substations, and generating plants in order to meet customer demand for electricity. The profitability and profit potential of that business is reduced as a result of the requirement to implement programs designed to reduce sales and reduce the need to invest capital in plant additions. As a result, utilities become less attractive to investors unless the reduced profitability in plant investments is replaced with a profit opportunity on the energy efficiency side so that it is more than just a "break-even" business proposition. In addition utilities are confronted with more risk associated with proper planning to meet customer needs due to the uncertainty associated with energy and demand savings for future planning purposes. As a practical matter, the requirements of the EUEA demonstrate that the proper balancing of interests includes a profit incentive for utilities on all cost-effective energy efficiency programs. This is explained further in the testimony of Mr. Graves.

Q. WHAT ADJUSTMENTS TO THE TRADITIONAL METHODS OF DETERMINING A REASONABLE PROFIT SHOULD BE USED TO

RECOGNIZE THE PRACTICAL REALITIES OF THE ENERGY EFFICIENCY BUSINESS?

A. PNM witness Graves describes a number of approaches for determining a reasonable profit for energy efficiency programs that have been used in other states. Mr. Graves has developed an approach appropriate for PNM to meet the directives contained in the EUEA and properly balance the overall public interest and the interests of customers and investors. First, the EUEA requires that the profit incentive be tied to satisfactory program performance. Mr. Graves's approach inherently is tied to program performance, i.e. the better the programs actually perform compared to how they were projected to perform, the greater the profit incentive. However, the amount of the profit is capped to assure that customers retain an appropriate share of the net benefits derived from the energy efficiency programs. Second, by using this attribute of the "shared savings method", PNM's recommended method is similar to the most commonly used methods in other states which provide profit incentives. Thus, it is consistent with the requirement of the PUA that the Commission give due consideration to ratemaking methods recognized by the laws of the land for ratemaking purposes. Third, basing the profit incentive on the amount of net benefits achieved by the energy efficiency programs in the manner proposed by Mr. Graves properly balances the overall public interest and the interests of customers and investors. The result is a just and reasonable rate consistent with the additional directives contained in the EUEA.

Q. HOW DOES THE TARIFF RIDER PROPOSED DIFFER FROM THE CURRENT TARIFF RIDER?

A. Mechanically, there are no changes to the rider in that it will continue to be applied as a percentage of customer bills, the method used by PNM and approved by the Commission in the past. The only proposed rider modifications are adjustments to the rate components to account for the new program budgets and incentive amount. The amount increases from 2.643% to 3.084%. The current rider amount of 2.643% includes three rate elements that reconcile past programs costs and incentives under-recovered in years 2009, 2010 and 2011. These three elements represent 0.381% of the current total rider rate. The rate rider element related to current programs costs based on the most recently approved energy efficiency plan is 2.150% and the rate element applicable to the previously allowed profit incentive is 0.112% of customers' bills. These amounts will increase to 2.598% and 0.486%, respectively, upon Commission approval of the 2012 Plan, as explained in more detail by PNM witness Bean.

Q. IS PNM INCLUDING ANY RECONCILIATION OF PROGRAM COSTS AND INCENTIVES IN THE REVISED RIDER REQUESTED IN THIS CASE?

A. No. Although the 2.643% rider currently charged to customer includes reconciliation amounts from years 2009, 2010 and 2011, PNM expects that these rate elements will expire before the approval and the effective date of the 2012 Plan. The estimated rider rate of 3.084% for the 2012 Plan includes only programs costs required to implement the 2012 Plan and the associated profit incentive.

Q. WHY DIDN'T PNM INCLUDE ANY RECONCILIATION AMOUNTS IN THE REVISED RIDER REQUESTED IN THIS CASE?

A. For the reconciliation of costs in calendar year 2012, PNM will be making the Annual Report filing on April 1, 2013, and will reconcile any over- or under-collected amounts for calendar year 2012, including a true-up of the rate elements discussed above. At this time PNM does not know what the amount of that reconciliation might be. So, rather than attempt to estimate the 2012 reconciliation amounts for purposes of the revised rider, PNM proposes to address the issue of any needed reconciliation separately in the 2013 Annual Report, when the exact amount of the reconciliation will be known.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

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