BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the	)	**Docket No. U-100522**
	)	
Conservation Incentive Inquiry	)	**NW Energy Coalition's**
	)	**Response to Consolidated**
	)	**Issues List**
	)	

In accordance with the May 13 Notice of Opportunity to File Written Comments, the NW Energy Coalition ("Coalition") respectfully submits the following responses to the Commission's consolidated list of issues in this docket. We do not respond to every question or sub-question raised in that list, but reserve the right to submit replies to responses from other stakeholders on the full list of issues.

In particular, we call attention to the following key points discussed in our responses:

- Initiative 937 is one important tool for ensuring electric utilities acquire cost-effective energy efficiency. Complementary policies – such as disincentive-removal mechanisms – will help ensure that I-937 is fully and successfully implemented over the long-term. And positive incentives to acquire energy efficiency that exceed a utility's targets will further benefit customers as well as the utility.
- Disincentive-removal mechanisms (such as decoupling or lost margin recovery) serve a specific purpose that is separate and distinct from positive incentives. These mechanisms must be properly designed in order to provide appropriate signals to utilities and to protect their customers from over-recovery.
- Evaluation, measurement and verification (EM&V) are critical to ensure performance and provide critical feedback on programs to allow timely midcourse corrections. In the case of lost margin recovery as a disincentive-removal mechanism, rigorous EM&V is essential to avoid under- or over-recovery.

Consolidated List of Issues

General

1. Definitions.

What is decoupling?

Decoupling is a mechanism that makes regular adjustments in retail rates to eliminate any difference between authorized and actual recovery of utilities' allowed revenues as a result of fluctuations in retail energy consumption (total or per customer). Decoupling assures recovery of a pre-defined or formulaic distribution revenue requirement, which has been approved by the regulatory agency in a rate case or other proceeding for that purpose. The allowed revenue requirement is fixed in a rate case by the regulatory agency, adjusted over time for inflation and

productivity, or adjusted to reflect customer growth or another metric of growth. The decoupling mechanism adjusts for any over- or under-recovery of the revenue requirement so that it is independent of sales volumes.

Jurisdictions vary on what costs are included within decoupling mechanisms. The mechanism can be designed to include a cap on periodic adjustments, to adjust for weather, or for other jurisdiction-specific needs. The adjustments can go up or down.

Decoupling is typically applied only to non-power or supply (electricity) or non-commodity (gas) costs (collectively referred to as "non-production" costs). When decoupling is applied to electric utilities it may be necessary to also account for net revenues earned from surplus sales freed-up by conservation savings (so as to avoid over-collection by the utility).

What is lost margin?

"Margin" is primarily a gas utility concept. Gas rates are divided into "gas costs" and "margin." The "gas cost" includes both capital and O&M costs associated with gas supply (wells, pipelines, processing stations, pipeline demand charges, LNG storage facilities) and volume-based costs (the commodity cost of gas). Translated to an electric utility, margin would mean all non-power costs.[1]

When discussing mechanisms to remove disincentives for utility investment in energy efficiency, the term "lost margin" recovery (also referred to as lost revenue recovery) refers to assured recovery of the lost margin -- the reduction in revenue to cover non-production costs -- due to specific, measurable programmatic energy conservation actions that can be tied to utility actions.

How is it measured?

Typically, lost margin is calculated by multiplying reductions in sales due to conservation program efforts by the amount of margin allocated per therm or kilowatt-hour in a utility's most recent rate case. Adjustments only go up. Rigorous measurement and verification are essential to ensure appropriate accounting of conservation program savings and to avoid over- or under-recovery.

Lost margin recovery typically only addresses savings due to utility funded programs, not codes, standards, government or consumer-funded measures. This biases the utility in favor of utility-funded efficiency and potentially makes it less willing to support these other actions.

What are fixed costs?

In accounting terms, the only completely "fixed" costs are interest and depreciation. However,

[1] The use of the term "margin" can be confusing, because it is also sometimes used to refer to costs, sales, or revenues, "on the margin." In this sense of the term, margin can refer to volumetric power or supply costs.

the term "fixed costs" is often used to refer to non-production costs.

2. Recovery of Conservation Program Costs. Are the utilities' conservation program costs recovered from ratepayers in a timely manner?

In general, Washington investor-owned utilities (IOUs) currently collect conservation program costs from ratepayers in a timely manner. Each utility recovers program costs through an annually applied mechanism, although those mechanisms and their application vary among the respective utilities.

Impact of Conservation Resource Development on Rate of Return

3. Statement of the Issue. Does the development of conservation resources deny the utility an opportunity to earn its allowed rate of return? Would an attrition study be the best way to determine this question? Are there alternative ways of making such a determination?

The development of conservation resources could adversely impact an IOU's ability to earn its allowed rate of return if and to the extent that sales are reduced below expected levels and the utility thereby under-collects its non-production costs. The development of conservation resources also could enhance the utility's ability to earn its allowed rate of return, e.g., if the utility's conservation frees up energy for sale to the market and the market price for power is high.

5. Direct Conservation Incentives and Rate of Return. What is the rationale for making incentive payments to utilities for acquiring conservation resources? Is it to encourage conservation? (See questions 14-17 below relating to conservation mandates.) Is it to ensure that the utility earns a sufficient rate of return? Does an incentive program act as an effective substitute for decoupling?

The purpose of a performance-based incentive mechanism is to encourage significant levels of cost-effective conservation. A utility may need more than timely cost recovery and mitigation of the disincentive in order to put energy efficiency on an equal footing with other utility investments. This is particularly important when resource acquisition levels are substantial. Incentives should reward superior performance and help ensure a utility aggressively pursues energy efficiency. In addition, an incentive can encourage a utility to accelerate the pace of acquisition of cost-effective energy savings. In summary, incentives should be put into place when energy efficiency programs are ramping up to high levels or to motivate a utility to continue performing at a high level.

State policy strongly supports the use of incentives to promote energy conservation. The Washington Legislature has declared that incentives that promote conservation benefit the state's

citizens by encouraging efficient energy use.[2] The Commission has recognized that state law and policy clearly support the use of financial incentives to promote a broad array of conservation measures.[3]

Disincentive-removal mechanisms, such as lost margin recovery and decoupling, must be regarded as separate and distinct from incentives. The former are intended to make utilities neutral to increases or decreases in the energy use of their customers. These mechanisms help motivate a utility to meet its conservation acquisition target[4] by ensuring that they are not harmed financially by doing so (and in the case of decoupling, while protecting customers from over-earning if loads increase faster than forecast). In contrast, an incentive is intended to encourage a utility to exceed its conservation acquisition target and to more fully incorporate conservation into its business plan.

Generally, an incentive program is not an effective substitute for decoupling. For example, the evaluation of the first two years of PSE's 2007-2009 pilot incentive program found that the approved incentives awarded based upon the 2007-2008 conservation programs amount to just over 25% of the lost margins that would persist until the assumed date of the next rate change.[5]

Ultimately, the design of an incentive or disincentive-removal mechanism is critical to its success. Further, no single mechanism to remove disincentives, create incentives, or both is perfect for all situations, and multiple approaches may produce equally beneficial results. If designed appropriately, a disincentive removal mechanism can be combined with an incentive to send a strong signal to the utility to aggressively pursue energy efficiency.

Details of a Conservation Incentive Mechanism

6. Categories of Lost Margin Due to Conservation Eligible for Recovery. Identify which, if any, of the following declines in customer use should be subject to recovery by the utility and how each could be calculated or measured:

- *a) Margin decline from company-sponsored conservation programs that provide a rebate or that provide direct assistance with conservation-measure deployment (such as site visit evaluation).*
- *b) Information provided by the utility to the customer, such as educational programs, bill inserts, or information on the utility's website.*
- *c) A company's share of Northwest Energy Efficiency Alliance (NEEA) regional*

[2] RCW 80.24.024; *see also* RCW 80.28.260 (support for policies that provide financial incentives for energy efficiency programs) and RCW 19.285.060(4) (the Commission may consider positive incentives for a utility to exceed the conservation targets established under RCW 19.285.040).

[3] *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-060266 and UG-060267, Order 08 at ¶ 153 (January 5, 2007); *see also WUTC v. Avista Corporation, d/b/a Avista Utilities*, Docket Nos. UE-090134, UG-090135, and UG-060518, Order 10 at ¶ 237 (December 22, 2009) (the policy of Washington State "encourages the Commission to consider incentives for investment in [conservation] resources").

[4] While I-937 requires utilities to set and meet energy efficiency targets, it does not address associated cost recovery issues.

[5] Blue Ridge Consulting Services, Inc. Independent Third-Party Evaluation of PSE's Electric Conservation Incentive Mechanism (October 24, 2009) at page 9.

conservation savings including market transformation that is not counted in the utility's programmatic or informational efforts. If yes, how can NEEA savings be separated from other conservation savings that occur for the purposes of a cost recovery mechanism?

d) *Independent customer conservation efforts (no rebate or direct utility assistance documented).*
e) *Conservation due to codes and standards.*
f) *Elasticity (i.e., heating fewer rooms, lowering thermostat, et cetera).*
g) *Substitution, such as switching from electric to gas, gas to electric, or to other heating sources, such as wood or thermal-solar hot water heaters.*
h) *Other (describe).*

Lost margin recovery requires precise measurement and verification to prevent over- or under-recovery. Company-sponsored conservation programs that provide a rebate or direct assistance are perhaps the easiest to measure and verify, but information and education programs are an essential part of an effective portfolio even though the direct impact is difficult to measure precisely.

Utilities can play an instrumental role in the adoption and implementation of efficient codes and standards, through direct programs, upstream programs, support for adoption, and enforcement training, among other activities. While the effect of the codes and standards can be estimated fairly reliably, attribution to a particular utility is more challenging. Independent or government-funded efforts, including tax credits, are other areas that become challenging when trying to estimate credit for the purpose of calculating a payment to utilities, even though the utility might have played a role in public education, support of public funding, or in other ways. It is also important to note that many of these categories are intertwined – for example, NEEA advocates for code improvements; information provided by a utility may lead to independent customer conservation efforts and fuel switching; etc. Utilities should support all of these efforts.

Full decoupling does not rely on these calculations for its result, focusing instead on comparing actual to expected sales and an already approved revenue requirement.

Any positive incentives offered to the utility should be based on performance of the utility in delivering energy conservation programs and savings.

7. Impact of Conservation Incentive Mechanism on Utility Incentives to Encourage Consumption.

If a utility recovers lost margin as calculated by installed conservation measures, does it still have an incentive to encourage customers to use more energy in some other application?

Lost margin recovery mechanisms are not designed to limit over-recovery due to increased sales. Under the lost margin recovery mechanism, the utility is compensated for its lost margins due to

measurable and attributable energy savings. If the utility also sells more energy than the estimate used to set rates, the utility would still collect the extra revenues as well. However, under decoupling, the utility that sells more energy than estimated would be required to return the over-collection in revenues to the customers.

Are any utilities promoting the use of more energy by its customers?

In the region, gas-backed heat pumps are being promoted by some electric utilities to the apparent consternation of some gas utilities, because these exacerbate gas system peaking costs, without contributing equitably to cost recovery. Heat pump incentives may serve as load-retention measures, enticing customers to not install gas space heat. As a result, space heating loads as well as water heat, clothes dryers and cooking ranges remain as electric loads. Electric vehicles (which will increase system load) are being promoted, but not necessarily by utilities.

8. Offsets. To what extent should any recovery of lost margin be offset by revenues associated with new load (sometimes referred to as "found margin"), including:

- *a) New customers,*
- *b) Additional load for existing customers,*
- *c) Other?*

In general, "found margins" should be considered to offset lost margins. It is important to recognize that new customers come with incremental costs as well as new revenues – both should be analyzed. Cost assumptions embedded in the utility's existing line extension policies also should be considered. Reduced electricity sales can avoid both investment in power supply resources as well as operating costs, purchased power and fuel. Finally, increased surplus sales of energy saved by customers can create new revenues.

9. Application to Industrial Customers. Should large customers be treated differently than residential or commercial customers with regard to lost revenue recovery or incentives? If so, please explain the rationale for excluding large customers.

Ideally, the utility disincentive would be removed for all customers. However, industrial customers with demand exceeding 1000 kVA (1 MW) and gas transport customers may be treated differently from residential and commercial customers because delivery costs are such a small part of the bill for these customers. In addition, these customers' bills already may be unbundled so that fixed and variable costs are billed separately; in those cases, reductions in usage should not create lost fixed cost revenues to the utility.

However, large customers should be an integral part of a utility's conservation program portfolio, and must contribute to program costs as well as the cost of any incentive mechanism. All customers ultimately benefit from utility acquisition of cost-effective energy efficiency, which lessens the amount they otherwise would have to pay for energy resources and reduces

emissions. Individual customers who participate in utility conservation programs also benefit directly through reduced bills, increased comfort and safety, etc. While efficiency efforts should be provided across all sectors, there are times when a particular sector has more, cheaper conservation available and a utility may disproportionately focus on that sector for a period of time. Again, though, all customers benefit from a cleaner environment and by energy bills that are lower than what they otherwise might be. Incentive mechanisms, as discussed in our responses to Question #5 and #14, can be used to motivate a utility to accelerate its acquisition of energy efficiency, which in turn lowers cost, risk and environmental impacts for all ratepayers. Thus, all ratepayers should contribute to such a mechanism.

10. Other Characteristics of an Incentive Mechanism. What characteristics should an incentive mechanism include?

a) *Should it allow the utility to recover an absolute dollar amount? If so, how should the amount be calculated? Should recovery be based on all conservation that occurs over a given period, or be proportional to the conservation that occurs as a result of a utility's actions?*

Incentive mechanisms should:

- Focus on savings (e.g., kWh, kW, carbon) not just "net benefits;"
- Consider, among other metrics, market transformation indicators, maximizing cost-effectiveness and net benefits, minimizing costs, and equity within and between customer classes; and
- Should be observable, measurable, verifiable, clearly aligned with policy objectives, and not create perverse incentives.

We also refer the Commission to Attachment A to the Coalition's Issues List in this proceeding, which includes a set of principles related to providing incentives for energy efficiency.

b) For electric utilities, should the incentive targets be different and greater than the Energy Independence Act (EIA or I-937) targets?

Yes. RCW 19.285.060(4) states, "The commission … may consider providing positive incentives for an investor-owned utility to exceed the targets established in RCW 19.285.040" (emph. added). I-937 already includes a penalty for failure to meet the established biennial conservation target, set initially at $50/MWh of shortfall (RCW 19.285.060(1)). The WUTC's implementing rules provide flexibility to the IOUs in defining their "pro rata" share of their 10-year conservation potential (as discussed in our response to Question 14), enabling utilities to set targets that are less than their proportionate share of the identified 10-year conservation potential.

Any incentive mechanism must be carefully designed to account for these issues, so that adopted policies do not inadvertently send a signal to utilities to essentially "lowball" their targets in order to avoid penalties and earn incentives.

c) Should there be penalties for failing to achieve the incentive mechanism's target or rewards for achieving only a percentage of the target?

The electric IOUs already face penalties under I-937 for failure to achieve a target. For electric IOUs, rewards should be provided for exceeding targets, not for achieving only some percentage of a target. For gas utilities, we recommend considering implementation of a deadband for penalties and rewards.

e) Should the incentive include all customer classes in the target and in the collection of the incentive payments?

Yes.

Impact on Rates

11. Impact on Various Classes of Customers. How should the costs of an incentive mechanism be spread among the various rate classes? Are transport customers appropriately protected from a recovery mechanism's costs?

The costs of an incentive mechanism should be spread in the same way as conservation program costs.

12. Impact on Low Income Households.

Should the design of an incentive mechanism consider its impact on low-income customers?

Yes. Creation of an incentive mechanism and/or a disincentive removal mechanism should include detailed analysis of the positive and/or negative impacts of that mechanism on low-income consumers; analysis indicating an "average" condition for residential consumers is not sufficient. Implementing such a mechanism should not increase the difficulty for low-income households to access utility services they can afford.

Minimization of fixed charge components of residential rates can help ensure that low-income consumers receive benefits from incentive mechanisms.

Would a lost margin recovery mechanism cause low-income households to bear a higher percentage of system costs?

A properly designed lost margin recovery mechanism should not cause low-income households to bear a higher percentage of system costs than other residential customers.[6] However, the

[6] A properly designed decoupling mechanism also should not cause low-income customers to bear a higher percentage of system costs.

energy burden on those low-income households (i.e., the percent of income paid for energy consumption) is typically greater than the burden on other residential customers, and any increase in energy cost will exacerbate that energy burden. Ultimately, any such mechanism should be designed to ensure its implementation does not result in an unwarranted shift in costs between customer classes or to low-income consumers.

In answering this question, it is also important to put into perspective the alternative: a utility that does not help its customers acquire all cost-effective conservation, opposes stronger codes and standards, and is forced to acquire expensive new resources to serve customers' growing loads. This is especially harmful to low-income customers who generally are not the primary contributors to load growth.

Are existing utility conservation programs for the residential class accessible to low-income customers?

It varies by utility. Low-income customers face additional obstacles beyond those faced by other residential customers, increasing the challenge of their accessing utility conservation programs. The basic barriers -- lack of time and knowledge – faced by all ratepayers may be exacerbated among low-income customers. Low-income customers also may be unable to take advantage of utility conservation programs because of the degraded condition of their housing stock. The utilities are restricted in the amount of dollars they can spend on energy-related repairs, if any at all, and the necessity for repairs essentially strands the potential energy conservation that could be captured. The lack of maintenance and the need for repair funds are high with low-income homes, even in gas-heated homes. As a result, low-income agencies are forced to reject income-eligible customers when repair dollars are insufficient to cover necessary work prior to installation of weatherization measures.

A major problem is that low-income families are more likely to rent than own, so are dependent upon landlords to make investments—investments that have little immediate payback for the landlord.

It is important to note that increases in energy efficiency program budgets for low-income consumers should be at least roughly proportional to the increases in funding for energy efficiency programs for other residential consumers. Such funding increases can help ensure that conservation programs are more equitably allocated between low-income and other residential customers. Ensuring energy-related repair dollars are available is critical as well.

If not, is the relationship between bill impacts and access to programs for low-income equitable?

No.

13. Impact on Utility Incentives.

Does the recovery of lost margin from conservation provide an incentive for the utility to control costs?

Between rate cases, a utility has an incentive to reduce its costs below those assumed in the rate case. This would be true for any lost margin or decoupling mechanism. But a narrow lost margin recovery mechanism can be effectively gamed, however, for several reasons.

First, even with perfect program design, lost margin recovery only addresses utility funded programs, not codes, standards or consumer-funded measures, thus biasing the utility in favor of utility-funded efficiency over do-it-yourself work. Ultimately, the most lucrative programs would be those that looked good on paper while saving little or nothing in practice (allowing double recovery of "lost revenues"); some of that could be avoided with good measurement, verification documentation and auditing. Unless reset in frequent rate cases, the rate impacts could be increasingly significant, because each year's savings and lost revenues would add to the previous year's total, and each stream of savings and payments could persist over decades, with steadily escalating financial consequences. And the utility would be recovering its "lost revenues" from energy efficiency gains without being required to give up its "found revenues" from growth in sales associated with economic expansion elsewhere on the system.

What is the incentive to minimize purchased gas adjustment (PGA) costs (within some risk level) if the utility is compensated for any decline in sales from conservation?

These are different issues. A fully-reconciled PGA has no incentive to minimize gas costs, regardless of what is done with conservation. Eliminating or reducing the customers' share of the PGA would be the best way to increase incentives for utilities to more effectively manage gas costs. Fully-reconciled fuel, purchased power, and purchased gas costs are well-recognized as powerful incentives for utilities to increase sales volumes.[7]

Relationship of Incentives to Conservation Mandates

14. Impact of Conservation Mandate in I-937. In light of the legal requirement for an electric utility to pursue all available conservation that is cost-effective, reliable and feasible under I-937, is it appropriate to provide an incentive to electric utilities for conservation?

I-937 specifically contemplates development of conservation incentives for IOUs. RCW 19.285.060(4) states, "The commission … may consider providing positive incentives for an investor-owned utility to exceed the targets established in RCW 19.285.040." The referenced targets include the biennial conservation acquisition targets established in RCW 19.285.040(1) as well as the renewable energy acquisition targets in RCW 19.285.040(2).

[7] See NARUC, Profits and Progress Through Least Cost Planning, 1989, at page 4. (http://www.raponline.org/Pubs/General/Pandplcp.pdf)

In particular, incentive mechanisms may prove useful because a utility's biennial target will reflect a portion of its long-term available cost-effective conservation, but will not necessarily reflect the totality of conservation savings the utility could acquire in that biennium. The pace of acquisition for retrofit conservation can be accelerated.

- The statute requires a utility to assess its conservation potential using methodologies consistent with the Northwest Power and Conservation Council ("Council"), and to use that assessment to calculate its biennial target (RCW 19.285.040(1)(a) & (b)). The Council's methodology results in an assessment of achievable, economic conservation, but does not include technology forecasting of measures becoming available after adoption of the Plan.
- The statute requires a utility to pursue its biennial target that is "no lower than" its pro rata share of its potential assessment (RCW 19.285.040(1)(b)). The Commission's rules appear to allow some flexibility in defining the term pro rata (WAC 480-109-007(14)), and the statute contemplates the possibility that a biennial target could be higher than a strict proportionate share of the 10-year potential assessment.
- The Council's Sixth Plan reaffirms that energy efficiency is the lowest cost and least risky resource (at p. 1-2). PSE's 2009 integrated resource plan ("IRP") states, "Acquiring demand-side resources – as much as possible, as soon as possible – is still the best strategy for avoiding both costs and risks" (p. 1-2).
- Incentives can be designed to encourage IOUs to exceed their biennial targets, thus lowering cost and risk for their customers. The conservation acquired in excess of those targets may include measures not considered in the Council Plan, and could still be cost-effective as measured on a program portfolio basis.

14.5. State Greenhouse Gas Emissions Reduction Goal (70.235.020). How would removing the linkage between the number of kilowatt hours sold and financial returns for utilities impact the state's ability to meet its statutory greenhouse (GHG) emission reduction limits (RCW 70.235.020)?

Energy efficiency acquisition, both within and outside the context of I-937, is a key strategy for reducing the state's greenhouse gas emissions. Each kWh saved generally avoids CO2 emissions. Yet there are many barriers to achieving energy efficiency. Utilities can support efforts to overcome these barriers, but only if they are motivated, or at least not penalized, to do so. Aligning the interest of utilities with those of its consumers and the environment by making utilities neutral to increases or decreases in the energy use of their customers can help lead to deeper commitments to energy efficiency. This in turn will yield reductions in GHG emissions, helping the state meet its statutory targets.

For example, a utility that is neutral to changes in its customers' energy use may be more motivated to support proposed state and federal efficiency standards, or promote enhancements to the state energy code. Currently, the WUTC's rules implementing I-937 are silent on whether or how an IOU can count changes in codes and standards within its biennial conservation target.

That uncertainty coupled with a lack of financial returns for conservation investments can remove any motivation for the utility to play a helpful role in passage of improved codes and standards. But codes and standards can be a critical source of savings – the Bonneville Power Administration ("BPA") anticipates that approximately 12% (60aMW) of the public utility share of the 6th Power Plan target over the first 5 years can be met through non-programmatic measures such as market-induced savings, tax credits, codes and standards, and non-BPA funding through the American Recovery and Reinvestment Act.[8] Enforced codes and standards result in near-100% achievement of savings, while utility programs seldom achieve saturation rates above 80% or so. And implementation of energy efficiency codes and standards will lead to reduced GHG emissions in new buildings and retrofits, helping the state reach its statutory limits.

15. Incentives to Exceed I-937 Targets. Under the EIA, the Commission may consider providing positive incentives for an investor-owned utility to exceed the conservation targets established in RCW 19.285.040. Do ratepayers benefit from encouraging the utility to pursue conservation that is not cost-effective and therefore beyond its target?

A well-designed incentive to exceed a biennial target would still promote acquisition of cost-effective energy efficiency. As discussed in our response to Question 14, a utility and its customers benefit from accelerated conservation efforts, in which lost opportunity conservation measures are realized sooner rather than later. These accelerated efforts go beyond a utility's biennial target.

It is important to note here that Commission policy encourages pursuit of a cost-effective portfolio of conservation programs. Utilities provide cost/benefit analyses of individual programs to aid in evaluating those programs and their associated incentive levels, but ultimately the cost-effectiveness of the entire portfolio is what matters.

16. Impact of Disincentive. As investor-owned electric utilities currently acquire more than their share of the Northwest Power and Conservation Council's assessment of conservation potential, does a disincentive to encourage conservation actually exist?

First, we question the premise that IOUs "currently acquire more than their share" of the Council's conservation assessment. The Commission recently approved Avista's biennial target under I-937 (Docket No. UE-100176), which represents its share of the Council's Sixth Plan (plus additional savings from fuel switching, which is not incorporated into the Plan). The Commission has not yet taken action on PacifiCorp's or PSE's targets. PacifiCorp's proposed target is based on its IRP with adjustments to the Sixth Plan where methodological differences existed, but according to its draft report, its ultimate proposal will be lower than its share of the Sixth Plan (Docket No. UE-100170). PSE has proposed a biennial target that is markedly lower than its share of the Sixth Plan; the legality of that proposal is awaiting summary determination in Docket No. UE-100177. We note that PSE's separately approved biennial conservation savings targets (with associated budgets) do exceed the Company's share of the Sixth Plan.

[8] Bonneville Power Administration's Integrated Program Review Energy Efficiency and Renewable Resources Technical Workshop, May 24, 2010.

That said, we would reframe this question to focus on whether a disincentive to conservation exists given that electric utilities have been ramping up their energy efficiency investments. The answer is yes, and now more than ever. Utilities invest in energy efficiency for various reasons. As those investments increase, as program savings increase, and as other load reductions occur (e.g., through savings due to new codes), the impact on non-production cost recovery grows and the disincentive to pursue conservation increases. Higher levels of investment that are not accompanied by financial returns to the utility are not sustainable, and can lead to a utility cutting its efforts to the minimum required by law and rule.

17. Natural Gas Planning. Does the lowest cost mix of resources described in WAC 480-90-238(2)(a)-(b) (natural gas integrated resource planning) require a gas utility to pursue all cost-effective conservation, i.e., conservation that has costs equal to or less than supply side resources?

Theoretically yes, but not necessarily in practice. WAC 480-90-238(1) requires, "Each natural gas utility regulated by the commission has the responsibility to meet system demand with the least cost mix of natural gas supply and conservation." The definitions of "integrated resource plan" and "lowest reasonable cost" referenced are included within requirements for the utility to develop a plan "to meet current and future needs at the lowest reasonable cost to the utility and its ratepayers" (WAC 480-90-238(2)(a)).

Ultimately, however, the plan does not bind the utility. The Commission almost always "acknowledges" a utility's IRP. According to the rules, "The commission will consider the information reported in the integrated resource plan, when it evaluates the performance of the utility in rate and other proceedings" (WAC 480-90-238(6)). In contrast, some states (e.g., Oregon) have rules that more strongly tie the acquisition process to the IRP process, and shift the burden of proof to the utility if it acquires resources not acknowledged by the Oregon PUC as part of the IRP.

Evaluation, Measurement and Verification

18. Use Per Customer as a Metric. Is use-per-customer for individual rate classes a useful metric for identifying conservation effects?

Yes, and analysis of use per customer is also a check on over-earning if a decoupling mechanism is in place. However, changes in use per customer compared with the long-term trend of use per customer (last 10 years or so, weather normalized sales) may be a more useful metric. That way we see what the utility is doing to improve the trend line.

20. *Methods for EM&V. Should the Commission establish a method, or general guidelines for an evaluation, measurement and verification (EM&V) methodology?*

Yes. It is very important to judge utility conservation efforts using the same protocols.

a) What role should a third party evaluator of EM&V play?

Third party evaluation of EM&V is very important to ensure performance and to provide critical feedback on programs to allow timely midcourse corrections, if necessary. As the Commission recently ordered within the context of establishing Avista's I-937 biennial target (Docket No. UE-100176, Order 01), Avista must spend 3-6% of its conservation budget on EM&V, including a reasonable proportion on independent, third-party EM&V. The Company must also ensure that all major programs are covered. An annual independent, third-party EM&V report involving analysis of both program impacts and process impacts must be part of the Company's Annual Report on Conservation Acquisition. We support similar requirements for the other IOUs.

b) Are EM&V methods accurate enough to use the history of individual customer usage as the basis for determining the payments in an incentive mechanism?

EM&V methods can be very effective in determining savings. Their use as a basis for the incentive depends on the design of the incentive mechanism. It is important to note, though, that history of customer usage may not provide a complete picture for purposes of designing an incentive mechanism.

c) *What role should the Regional Technical Forum play in EM&V issues?*

The RTF should play a critical role in EM&V issues, and we urge the Commission to approve IOU funding of the RTF. The RTF issues deemed savings for a wide variety of measures, enabling uniform, consistent standards across the region. The RTF also has developed simple, consistent reporting formats. That said, the RTF has only just begun to consider expanding its role into process and impact evaluation of more custom measures and programs.

21. Impact on Cost-Effectiveness of Conservation Measures. If lost margin is recovered in rates, should the cost be included in the cost-effectiveness test? How much would the inclusion of those costs decrease the amount of conservation achievable under the cost-effective threshold?

No, because this is not a cost (land, labor, capital, entrepreneurship) - it is a reallocation of responsibility for cost recovery for allowable costs, restoring revenues to cover costs that exist with or without the conservation measure implementation, but are not fully recovered with conservation implementation.

With decoupling, the adjustment occurs as a periodic, small increase or decrease in rates and is

not a cost, since it only allows recovery of the allowed revenue requirement. Both lost margin recovery and decoupling are transfer payments, not an additional cost. It would not be appropriate to include either in a cost-effectiveness test.

Relationship of Conservation Incentives to Utility Return on Equity

22. Effect of Incentive Mechanism on Allowed Return on Equity. Should adoption of an incentive or lost margin/decoupling mechanism require a downward adjustment in the utility's return on equity?

Any mechanism that is found to significantly increase or decrease shareholder risk should potentially include an appropriate increase or decrease in the allowed shareholder return. An evaluation must be conducted to determine whether a mechanism (e.g., a pilot decoupling mechanism), that is time-limited and of sufficient duration, impacts shareholder risk and affects investment community perceptions such that an adjustment in return on equity (ROE) would be appropriate.[9]

23.Incentive Rate of Return.

Should a utility earn a return on monies collected from ratepayers to fund its conservation programs? If so, please explain.

No. Utilities are allowed a return on capital invested by shareholders. Most of the monies collected from ratepayers to fund conservation program are applied to conservation program operating expenses. Utilities do not earn a return on other operating expenses, and they should not earn a return on conservation operating expenses. An incentive mechanism, however, can address how the utility achieves net savings for consumers, and this includes recognition of strategies that minimize operating expenses associated with conservation programs. However, if a utility chooses to capitalize some of its energy efficiency investments then it will earn a return on those investments.

Would the amount of energy efficiency offered by the utility increase under either of the above circumstances?

Possibly, to the extent the incentive is performance-based.

[9] We note that generally commissions rely on market information to set ROE. If a disincentive-removal mechanism changes a utility's risk profile, we would expect the market, including rating agencies, to react to that fact. This information would then be included in the Commission's next ROE setting opportunity.

Other Issues

24. Other Issues. Comment on any other issue relevant to this inquiry that is not covered above.

We recommend:

- Ensuring that an independent evaluation is conducted to examine the effectiveness of any incentive mechanism or disincentive removal mechanism after at least three years in operation.
- Determining whether it is possible in the context of this proceeding (vs. in a specific utility proceeding such as a rate case) to address possible interactions between various mechanisms (incentives, disincentive-removal, other).
- Thinking creatively about possible incentive mechanisms for encouraging utilities to accelerate their energy efficiency acquisition.