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David Danner, Executive Director & Secretary
Washington Utilities and Transportation Commission
1300 S Evergreen Park Drive SW
Post Office Box 47250
Olympia, WA 98504-7250

RE: Docket U—100522 Cascade Natural Gas Corporation's Comments Regarding "*Investigation of Conservation Incentives*"

Dear Mr. Danner:

Cascade Natural Gas Corporation (Cascade) submits the following comments in response to the May 19, 2010 Amended **Notice of Opportunity to File Written Comments.** These comments include general observations on Conservation Incentives, as well as specific responses to issues identified on the Consolidated Issues List:

General Comments on Conservation Incentives

For the past three years, Cascade has operated under a decoupling mechanism designed to allow the Company to aggressively promote and pursue conservation without impacting the Company's ability to recover its fixed cost due to lower sales volumes. Since 2007, when Cascade's decoupling mechanism went into place, our conservation activities and achievements have increased steadily every year. We believe that the mechanism has removed the disincentive to promote conservation. Out of the three ways that are being discussed in this rulemaking to promote conservation; a conservation incentive payment, recovery of lost margins, and decoupling, Cascade believes a decoupling mechanism similar to Cascade's current mechanism is the best approach for a natural gas utility to continue to promote conservation.

Cascade favors a decoupling mechanism that is uncomplicated and easy to administer, similar to the mechanism Cascade currently has in place in its Washington and Oregon jurisdictions. In general, the Company believes that a mechanism should be applied to the customer classes that are homogeneous in nature, typically residential and small commercial customers. A mechanism that compares actual customer usage and weather normalized actual usage and margin to the weather normalized usage and margin reflected in its last general rate case is both simple to calculate and easy to administer.

The Company also believes that it is important to recognize that there are substantial differences between Natural Gas and Electric companies and how they operate, therefore tailoring a single mechanism to be applied to all utilities may be difficult. The key difference is natural gas companies do not make a profit on purchased gas costs but rather earn a return on investment in its distribution system. Cascade believes that providing flexibility through different types of mechanisms is the key to allowing utilities to promote conservation without being harmed financially.

Comments in Response to Issues Identified by Parties in U-100522

General

1. ***Definitions.*** **What is decoupling? What is lost margin? How is it measured? What are fixed costs?**

Comment: Decoupling is used to eliminate the relationship between volumetric sales and recovery of a utility's fixed cost. For natural gas utilities, the costs for delivering natural gas are relatively fixed on a per customer basis. Under traditional rate design, most of the utility's cost recovery is assigned to the volumetric rate such that any loss in the volume of sales reduces the utilities ability to recover its fixed cost and earn its allowed rate of return.

Lost margin refers to the margin lost by the Company due to a reduction in sales. Simplistically, lost margin is measured by multiplying the lost volumes by the per therm margin rate a utility receives.

Fixed costs are those costs incurred by the utility that remain relatively the same regardless of sales volumes to the Company's customers. These costs increase as the number of customers increase. For each new customer, new plant must be added to the distribution system and a new account must be established to track services consumed by the new customer. The operations and maintenance expense of the new plant, the return on the investment and administration expense remain the same regardless of how much or how little the new customer consumes.

2. ***Recovery of Conservation Program Costs.*** **Are the utilities' conservation program costs recovered from ratepayers in a timely manner?**
   a. **If cost recovery is untimely, please describe how and why.**
   b. **Are there other methods of funding conservation programs that would be more efficient and effective at acquiring conservation resources?**

Comment: Administrative and programmatic delivery costs associated with Conservation Program should continue to be accounted for and recovered through either a temporary technical adjustment mechanism or a conservation rider mechanism that is updated annually. Temporary surcharges are applied to participating rate schedules over the following 12 month period.

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?**

Comment: Yes, the acquisition of conservation resources can deny the utility the opportunity to earn its allowed rate of return. This is because the revenue a utility collects is largely dependent on sales volumes under current rate design. Any loss in sales reduces the utility's margin and thus its ability to cover fixed expenses and earn its allowed rate of return. An attrition study is one tool to answer this question but the reduction in usage is tough to analyze and attribute to any one reason.

4. ***Magnitude of the Risk.*** **How much lost margin can be attributed to each utility's conservation programs? How much lost margin can be attributed to the other types of conservation referenced in question 6 below?**

Comment: Determining the lost margins due solely to a utility's conservation programs is difficult. The amount of energy to be saved from various conservation measures and demand side management programs is established in the utility's Integrated Resource Plan and is the basis for determining cost effective measures to be pursued through utility sponsored programs. The type/size dwelling in which a conservation measure is installed, and the energy utilization choices made individual customers, affect the overall effectiveness of a measure. Therefore the level of saving per measure must be established on a generic basis and should not be the utilities' responsibility.

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?**

Comment: Cascade does not believe that an incentive program is an effective substitute for decoupling. This is because incentive programs often include a penalty for not reaching conservation targets. The fundamental problem with this type of program is that a utility can aggressively promote conservation but ultimately the customers decide whether to participate in the programs. By tying the conservation incentive payments to conservation achieved by the utility, the utility is still at risk for any conservation achieved by its customers that is outside its program. So while a customer may not participate directly in the Company's conservation program, they may hear the conservation message of the Company and pursue conservation on their own. Under this type of mechanism, those achievements wouldn't be counted as conservation achieved.

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 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).

Comment: Cascade believes that any decline in customer usage should be subject to recovery by the utility. This is because under the current rate structure, any reduction in usage reduces the utility's ability to cover its expenses, which are largely fixed, and earn its allowed rate of return. By including some measures that reduce usage but not others the utility is still harmed and it makes the calculation of the lost margins by conservation measures a contentious process.

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

Comment: Recovery of lost margins and other methods of decoupling make a utility neutral to conservation by mitigating losses resulting from the reduced use of their product. However, it has been widely acknowledged by environmental organizations that the direct use of natural gas has many environmental and societal benefits, particularly when it is partnered with the installation of high efficiency equipment. Thus the WUTC could reasonably anticipate a utility engaged in socially responsible programs (both electric or gas) to consider messaging that encourages the wisest use of energy, which in some cases would result in conversion from electricity to natural gas -- and a net reduction in overall energy usage.

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?

Comment: Changes to revenues associated with new load should not be considered an offset to the lost margins associated with conservation since fixed costs will increase with addition of new customers. For each new customer, new plant must be added to the distribution system, a new account must be

established and the company will incur additional operations and maintenance expense associated with the new plant.

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.**

Comment: Under a decoupling mechanism, large volume customers have to be treated differently than residential or small commercial customers because typically these customers aren't homogeneous enough as a group to be included in a decoupling mechanism. There are large variations in usage between large volume customers.

10. *Other Characteristics of an Incentive Mechanism.* **What characteristics should an hincentive 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?**

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

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

d) **Should there be an earnings test to determine if the utility is over earning?**

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

f) **Are there other complementary rate making policies that should be matched with an incentive mechanism such as a pro forma adjustment to account for lower loads? Please provide details of any such proposals.**

Comment: Cascade does not believe an incentive mechanism would properly address the reduced usage natural gas companies are seeing with its customers for the reasons described in #5 above. The Company believes that a decoupling mechanism is the best approach to remove the disincentive for a utility to promote conservation. The Company also believes that while an earnings test may be appropriate, some sharing above the cap is necessary. Limiting the recovery of lost margins to an earnings test produces a disincentive for the utility to reduce its costs and become more efficient.

Impact on Rates

12. *Impact on Low Income Households.* **Should the design of an incentive mechanism consider its impact on low-income customers? Would a lost margin recovery mechanism cause low-income households to bear a higher percentage of system costs? Are existing utility conservation programs for the residential class accessible to low-income customers? If not, is the relationship between bill impacts and access to programs for low-income equitable?**

Comment: The design of any rate recovery mechanism should consider the benefits and the impacts on

both ratepayers and the utility. Cascade's experience from both its Oregon and Washington pilot program have found that the costs per customer resulting from decoupling have been minimal. To date, customers are not flagged or tracked by their income status and the Company believes it would be inappropriate to do so. However, to ensure that all customers have equal opportunity to engage in home energy efficiency improvements, Cascade provides critical funding to the low-income Weatherization Assistance Program. These funds allow a greater number of income-qualified customers to receive conservation.

13. ***Impact on Utility Incentives.*** **Does the recovery of lost margin from conservation provide an incentive for the utility to control costs? 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?**

Comment: Utility companies always have an incentive to control costs regardless of whether the utility has the ability to recover lost margins due to conservation or not. If costs are not kept in control, the company will not earn its authorized rate of return which could impact their financial stability. However, a mechanism that requires the utility to be below its authorized rate of return before it is allowed to recover lost margins creates a disincentive for utility to pursue operational efficiencies that control costs.

The Company does not believe that there is a link between recovering lost margins and natural gas costs in a PGA. Gas costs are paid 100% by a utility's customers and all natural gas purchases by a utility can be subject to a prudency review. It is Cascade's goal to provide reliable service at the lowest cost to its customers, and the Company's decoupling mechanism has no impact on this goal.

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?**

Comment: Yes. Utilizing use-per-customer for an individual rate class is the best metric for identifying conservation since it captures *all* conservation efforts (including reduced usage resulting from both physical EE improvements (programmatic) and soft conservation from behavioral changes). Cascade maintains its belief that any decline in customer usage should be subject to recovery by the utility because any reduction in usage reduces the utility's ability to recover its fixed costs and earn its allowed rate of return.

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

- **a) What role should a third party evaluator of EM&V play?**
- **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?**
- **c) What role should the Regional Technical Forum play in EM&V issues?**

Comment: If EM&V is determined critical to the evaluation process, the Company recommends that the state establish a 3rd party evaluator to develop a formal list of deemed therm savings estimates (by climate zone) for use by all utilities. Such an approach would allow the utilities to focus their efforts on the management of participants through the development of incentives and the promotion of critical energy

efficiency measures. Until such universal therm savings are developed, the Company does not believe the utilities should be held accountable for differences between deemed therm savings developed in good faith, and "actual" therm savings carved out of an EM&V proceeding. We would conversely be opposed to having each utility invest rate payer dollars in a study that did not capitalize upon the economies of scale of having a singular state-sponsored study performed across Washington.

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?**

Comment: Cascade believes that the adoption of an incentive or lost margin/decoupling mechanism shouldn't require a reduction to the utility's return on equity. There are plenty of risks facing a natural gas company including market risk, business risk, regulatory risk, etc. that require the utility to have an appropriate return on equity in order to compensate for that risk. Lowering the return on equity could impact a utility's ability to attract capital. Natural Gas utilities have been experiencing declining usage per customer for some time now. By allowing the utility to recover these lost margins between rate cases it allows the Company to actively promote conservation and not have to file frequent rate cases which are expensive to our customers.

The Company appreciates the Commission's consideration of our comments and we look forward to participating in future meetings and workshops as these issues are discussed.

Sincerely,

Katherine J Barnard

Katherine J. Barnard
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