BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Conservation Incentive Inquiry	DOCKET NO. U-100522

REPLY COMMENTS OF PUBLIC COUNSEL
IN RESPONSE TO STATEMENT OF INQUIRY
June 18, 2010

I. INTRODUCTION

In these Reply Comments Public Counsel addresses a number of specific points raised in other participant comments. We look forward to further engagement on these issues at the upcoming workshop. One theme that Public Counsel identified in its review of the comments to date, particularly from utilities, is a de-emphasis of conservation incentives and a focus instead on pure cost recovery arguments and issues. A number of commenters suggest that decoupling mechanisms should compensate utilities for revenue declines from any reason, whether or not declines are related to company conservation programs. Commenters argued there was no need to use rigorous evaluation (EM&V) methodologies to measure conservation outcomes if decoupling was adopted. Given that decoupling has almost uniformly been advocated by utilities and some conservation supporters as a key part of improving conservation performance, this change of emphasis is somewhat surprising. This proceeding has sought to focus on

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conservation incentives and utility achievement of conservation. If the utilities' interest is instead in analysis of ratemaking methodology, fixed cost recovery, rate of return and future test years, then that is a different type of analysis that may not be best-suited to this docket as it is currently constituted. Expertise in accounting, finance, ratemaking methodology and cost-of-service analysis would be helpful in assessing these issues.[1]

PSE's comments provide some information about the activity around the country with regard to decoupling and conservation incentives. At the conclusion of the evidentiary hearings in Avista's 2009 general rate case, the Bench asked all parties to provide a survey of the status of decoupling in the United States in their post-hearing legal briefs. That information is also available to the Commission and parties in this proceeding.[2]

II. REPLY COMMENTS

General

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

The Northwest Energy Coalition (NWEC) provided a definition of decoupling that states: "The decoupling mechanism adjusts for any over- or under-recovery of the revenue requirement so that it is independent of sales volumes."[3] While this is certainly one of a number of possible definitions for decoupling, decoupling in this form is actually quite different from the

[1] On an individual company basis, these issues are analyzed in each company rate case, using these areas of expertise.

[2] *See e.g.,* Brief of Public Counsel, UE-090134 & UG-090135, consolidated with UG-060518, November 10, 2009, Attachment A. Other party surveys are available from the Commission's website under this docket number as attachments to post-hearing briefs.

[3] NW Energy Coalition's Response to Consolidated Issues List (NWEC Comments), p. 2.

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two gas decoupling mechanisms that have been approved by the UTC.[4] Those mechanisms are not based on the overall approved revenue requirement, but instead are designed around usage per customer. The NWEC definition describes what is sometimes known as "full decoupling." Decoupling in this form is essentially a revenue stabilization device that fully guarantees that the utility will recover its authorized revenue under all circumstances. This guarantee has never been a part of utility regulation in the United States. Utilities are provided the opportunity to earn a reasonable rate of return through prudent management, not a guarantee.[5] With full decoupling, any incentive to operate efficiently or to control costs is eliminated, because any revenue shortfall is simply replaced by a surcharge imposed on ratepayers. Conversely, if revenues grow above the level authorized by the Commission, the utility must return the excess to customers.

Because of this latter feature, it is not surprising that utilities have not proposed the type of decoupling described by NWEC. This is because both gas and electric utilities continue to see overall growth in total sales and revenues. If decoupling were based on total revenues, under the NWEC definition, utilities would be making regular payments to their customers because of this growth pattern. Instead, most utility decoupling proposals focus on average sales *per customer* where the utility can isolate a decline. Even here, the per customer declines are primarily for gas customers. Average sales for electric customers have not shown patterns of decline, although the economic downturn has in the short term shown some flat or slightly

[4] *WUTC v. Cascade Natural Gas Corp*., Docket UG-060256, Order 05, January 12, 2007, ¶¶67-85 (Cascade 2006 GRC); *WUTC v. Avista Corporation*., Docket Nos. UE-090134 & UG-090315, consolidated with UG-060518, Order 10, December 22, 2009, ¶¶ 236-309 (Avista 2009 GRC).

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downward drops in average use. This is likely the reason why no Washington electric utility has proposed decoupling for its electric operations in recent memory, with the exception of the PacifiCorp filing in 2005.[6]

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?*

Most of the utility company comments agree there is no serious issue with the timeliness of the recovery of conservation program costs. As various commenters note, these costs are fully recovered from customers, a fact not always fully understood outside the regulatory arena. Utility companies do not subsidize or "donate" the costs of their conservation programs. The programs are fully, completely, and timely funded by their customers. In the case of PSE for example, through a surcharge on each monthly bill, PSE customers are now paying approximately $100 million annually for conservation programs, in addition to the price they pay for their electric usage, and other items on the bill.[7]

Impact of Conservation Resource Development on Rate of Return

[5] *Regulated Industries In A Nutshell*, Richard J. Pierce, Jr. & Ernest Gellhorn, West Group, Fourth Edition, 1999, pp. 97-98. *See Board of Public Utility Com'rs v. NY Tel. Co.,* 271 U.S. 23, 31 (1926); *see also* Goodman, *The Process of Ratemaking*, (Public Utility Reports, Inc., 1998), p. 166.

[6] *WUTC v. PacifiCorp dba Pacific Power & Light*, Docket UE-050684, Order 04, ¶¶ 108-110. Although the PacifiCorp proposal in that case was not approved, the Commission urged the company to develops a more detailed and comprehensive proposal which met the criteria in the order. PacifiCorp has not to date filed such a proposal. Neither PSE nor Avista has requested electric decoupling in the past decade.

[7] Puget Sound Energy 2010-2011 Energy Efficiency Services Tariff Filing, Docket Nos. UE-091859 & UG-091860, Appendix B. This document provides the budget and estimated savings for the electric and natural gas conservation programs over a two-year period (2010-2011), with a total budget of $200 million.

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?

Significantly, PSE comments that development of conservation resources does not by itself deny PSE a return.[8] The company theme instead is that it is not recovering its costs. It argues, *inter alia,* that its cost recovery would be aided by use of a "future test year" approach to ratemaking. This ratemaking issue is not directly germane to the conservation incentives inquiry as such and is best addressed in a rate case. However, it is worth recalling that, under Washington's current "modified historic test year" method, a company's recoverable costs and expenses to be built into new rates are based on actual known historic costs from the year just prior to the rate case (the test year), as modified with known and measurable costs that will occur in the future period when the new rates go into effect. This approach bases rates on actual company expenses and avoids reliance on future unknown or unmeasured expenses. This methodology was in fact very recently reaffirmed by the Commission in PSE's and Avista's 2009 rate cases, in the face of efforts by both companies to base rates on estimates and projections of costs rather than known expenses.[9]

Ratemaking by definition allows utilities to request and requires the UTC to determine a revenue requirement designed to recover all of a utility's prudently incurred costs, including fixed costs, and a return on its investment. PSE has filed rate cases freely over the past ten years, with a new rate case approximately every 12 to 18 months, and

[8] Comments of Puget Sound Energy, U-100522, June 4, 2010, p. 6.

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receiving increases in rates totaling $213 million for electric and $88 million for gas in the last three years alone. Similarly, over the past three years, Avista has been granted an additional $74 million in electric revenues, and $8 million in natural gas revenues. Data for PSE and Avista's recent rate cases is shown below in Tables 1 and 2.

Table 1. PSE Rate Case History

Case	Elec. Revenues Granted	Gas Revenues Granted	Total Revenues Granted
UE-072300 & UG-072301	$130,179,688	$49,212,697	$179,392,385
UE-090704 & UG-090705	$74,060,716[10]	$10,149,229	$84,209,945
Total Revenues Granted In Last Three Years	$213,484,773	$88,840,926	**$263,602,330**

Table 2. Avista Rate Case History

Case	Elec. Revenues Granted	Gas Revenues Granted	Total Revenues Granted
UE-070804 & UG-070805	$30,166,000	$3,282,000	$33,448,000[11]
UE-080416 & UG-080417	$32,500,000	$4,768,000	$37,268,000
UE-090134 & UG-090135	$12,108,000[12]	$557,000	$12,665,000
Total Revenues Granted From Last Three Years	$74,774, 000	$8,607,000	**$83,381,000**

[9] Avista 2009 GRC, ¶¶ 40-50; *WUTC v Puget Sound Energy, Inc*., Dockets UE-090704 & UG-090705, Order 11, April 2, 2010, ¶¶ 22-33 (PSE 2009 GRC).

[10] PSE 2009 GRC, Order 12, p. 9.

[11] Electric & Gas Comparison of General Rate Cases and Purchase Gas Adjustments 2000 to present, WUTC website: http://www.utc.wa.gov/webimage.nsf/e827858488fbdbaa88256efc00506bb3/dcf99908409a29448825709700726f24!OpenDocument. Unless other wise cited, all revenue sources shown in Tables 1 and 2 are derived from this Excel spreadsheet.

[12] Avista Tariff Revision Filed December 28, 20009, Docket UG-090134, UE-090134. The electric revenue increase approved granted for 2010 rates does not include the effect of the supplemental compliance related to the ERM and the methodology that the Commission will eventually approve for calculating the deferred costs associated with Lancaster contracts, as anticipated in Order 10, paragraph 230.

PSE's future test year argument appears to be an effort to revisit arguments rejected in its most recent rate case. The "future test year" approach recommended by PSE, relies extensively on projections and estimates of what expenses will be in a "future test year" in order to set rates. This methodology is far more uncertain and speculative and exposes customers to significantly greater risk of paying unwarranted, excessive, or inaccurate charges.

Avista's comments on this issue make several interesting points. Avista agrees that conservation is the least cost resource and provides some data reflecting significant cost advantages of conservation when compared to other power resources.[13] This underscores Public Counsel's comments that acquisition of conservation as a resource is actually beneficial economically to utilities, a factor to bear in mind when considering the need for incentives.

Avista argues that "returns are universally accepted as necessary" for the sustainable provision of utility service and that "recovery of all costs (including fixed costs) and a return is *not* currently provided in Washington." This relies on an incorrect premise that there is a legal expectation of guaranteed cost recovery and return under rate regulation. Regulation seeks to emulate the effects of competition, which does not guarantee returns or cost recovery for firms in the marketplace. Instead, rates are set at a level which allows a utility *the opportunity* to earn a return and recover its costs if the utility is prudently and efficiently

[13] Comments of Avista Utilities (Avista Comments), June 4, 2010, p. 3.

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managed.[14] It is therefore simply incorrect to imply that Washington does not allow for recovery of costs and a return on investment.[15]

Avista also fails to mention in this section of the comments that the Commission has approved three additional cost recovery mechanisms for the company *in addition* to its general rates: (1) Avista's decoupling mechanism, newly approved for permanent continuation after a three year pilot,[16] (2) the ERM (Energy Recovery Mechanism) that allows Avista to recover additional electric power costs from customers in between rate cases when the power costs exceed a baseline level already built into rates; and (3) a PGA (purchased gas adjustment) which allows Avista to pass through its natural gas commodity costs to customers in between rate cases. All of these mechanisms augment cost recovery and support returns, and reduce Avista's financial risk as well.

Avista states it does not support the use of an attrition adjustment because attrition adjustments typically require a showing of financial hardship.[17] If utilities would have trouble showing that financial hardship is caused by conservation and unrecovered fixed cost, however, it seems reasonable to ask how serious the underlying problem is.

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?

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[14] *POWER v. Utilities and Transportation Comm.,* 104 Wn. 2d 798, 808-813 (1985).

[15] As a factual matter, Avista's statement that returns are "universally accepted" as necessary for the provision of utility service is only true as to investor owned utilities. Municipal utilities and public utility districts in Washington are not required to provide a return (profit) to equity investors.

[16] Avista 2009 GRC, Order 10, ¶¶ 236-309. This is an interesting omission since this is the topic of the rulemaking. It is not readily apparent from Avista's comments that they have actually had decoupling in place for over three years and are approved to continue it indefinitely.

[17] Avista Comments, pp. 4-5.

This is one of the most important questions posed in the rulemaking. Utilities and other proponents were given the opportunity to quantify their "lost margins" and to verify that they are of sufficient size as to warrant some response. The information provided in the comments is less than persuasive.

PSE has provided data regarding its lost margins in appendices to its comments.[18] There are several questions about the data however: (1) the figures appear to be based on the same concept of the "conservation phase-in adjustment," which was recently considered and rejected by the Commission after thorough review in the company's last rate case;[19] (2) the PSE figures do not appear to take into account any offsets, such as increased usage due to new appliances; (3) the figures appear to be cumulative, reflecting reduced usage since October 2004. The calculations, therefore, may not take into account that intervening rate cases have occurred, and usage is re-set in each rate case; (4) the Blue Ridge report ("Phase I report," covering the first two years of the PSE's ECIM conservation incentive mechanism), states that in each of the past five years, actual sales to consumers have exceeded the company's load forecast.[20] This is discussed more fully in connection with load forecast issues in question 19. In general, however, this supports the point that there are many drivers affecting ultimate sales to consumers. In the end, even the load forecast is an estimate; (5) lost margin amounts provided

[18] PSE Comments, Attachments A, B, and C.

[19] PSE 2009 GRC, Order 11, ¶¶ 36-50. The Commission concluded: "Measured against familiar principles of ratemaking, the proposal does not pass muster as a proper pro forma adjustment. It plainly fails to take obvious and indisputable offsetting factors into account, thus violating the matching principle. Moreover, the evidence PSE presented to support the adjustment as being known and measurable is simply inadequate to its intended purpose." *Id*. ¶47.

[20] *Independent Third-Party Evaluation of PSE's Electric Incentive Mechanism*, Prepared by Blue Ridge Consulting Services, Inc., October 24, 2009, p. 66 (Blue Ridge Phase I Report). The Phase I Report covered the first two years of the pilot that concluded December 31, 2009.

by PSE to Blue Ridge, and shown in the Blue Ridge report (both Phase I and Phase II), appear to be different from those provided by PSE in this rulemaking. All calculations were done by PSE, but this shows that there are multiple ways to calculate these figures (e.g. for example, first year basis versus cumulative basis).

Avista provides some lost margin information for 2009 in its comments. One problem immediately apparent is that Avista's numbers literally "do not add up." While Avista's table states that the lost margins for 2009 programmatic DSM are $1.45 million, the component line-items provided for each tariff only add up to $310,613. Avista has not provided a source for this data. Again, as in the response to prior questions, Avista makes no mention of its own decoupling mechanism or of the data on lost margins developed in connection with its decoupling pilot and the related approval process. It is not clear how the data in Avista's rulemaking comments relates to the data available from its decoupling mechanism. This is an important question.

At the present time, Avista's mechanism, and the data developed during the approval process, provide the most recent source of reasonably reliable data about the size and nature of lost margins for a utility in Washington. Avista's data thus provides the best factual basis currently available for testing the hypothetical claims of proponents, and evaluating critiques of this approach. Public Counsel's initical comments cited the information available from Avista's decoupling case, which showed that the total lost margins related to programmatic were only a fraction of the margin declines experienced by the company.[21]

One theme seen in several comments was that it is both difficult and unnecessary to

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separate out the declines in usage due to company programs (programmatic DSM) and all other causes. Public Counsel disagrees. It is possible to quantify the amount of conservation due to company programs and this was in fact done in the Avista decoupling proceeding. Secondly, it is critical to do so. If not limited to company programmatic DSM, decoupling is simply a crude catchall that recoups and compensates the utility for usage declines that occur for any reason, most of which, by definition, have no connection to utility conservation activities. This is simply a windfall for the utility. It is also logically inconsistent. Since decoupling is justified as a way to remove the disincentive to sponsor conservation, it makes no sense to tie decoupling mechanism payments to factors that have nothing to do with utility conservation programs and therefore have no effect on utility motivation or incentives.

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?*

Utility comments were fairly consistent on this issue. PSE argues that decoupling and incentives are different and distinct approaches.[22] Avista states that decoupling is not an incentive mechanism, while Cascade states it does not support incentives, only decoupling. PacifiCorp states it is not advocating for incentives but that the removal of disincentives is appropriate.

[21] Comments of Public Counsel, June 4, 2010, p. 11, Chart 1.
[22] Comments of Puget Sound Energy, Inc., (PSE Comments), June 4, 2010, p. 7.

The NWEC argues generally that incentives are not a substitute for decoupling.[23] In support of this point NWEC cites information from the Blue Ridge Phase I report purporting to show that only 25 percent of lost margins were recovered by PSEs' conservation incentive program (ECIM). It is important to recognize, however, that the figures in the Blue Ridge report were not developed, calculated, or verified by Blue Ridge itself, but were simply provided by PSE to the consultant and repeated in the report.[24] Because PSE allowed its ECIM conservation incentive mechanism to expire, the data from the ECIM has not been rigorously analyzed in a Commission proceeding. Moreover, during the time period covered by the Blue Ridge report, PSE's actual conservation acquisition exceeded targets so it is not clear why there is a need for any added decoupling mechanism to remove a disincentive.

None of the lost margin numbers provided in this docket make reference to offsets of any kind. This can occur, for example, when a company exceeds conservation targets, as PSE has done recently, freeing up power to be sold on the wholesale market. The revenues from these sales should be treated as an offset to any revenue declines from reduced consumption.

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

[23] NWEC comments, p. 4.
[24] Blue Ridge Phase I Report, Preface, p. i.

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).*

A number of party comments on this question avoid the gist of the question by simply arguing for recovery of all revenue declines from any cause, thus obviating the need to identify declines due to utility company conservation. As noted elsewhere in these comments this is an overly broad approach that treats the customer as the company's insurer for revenue losses from any cause. While some of the items on the list are difficult to calculate, the Commission and parties have demonstrated the ability to identify the declines that are due to company conservation programs, as opposed to the list of other causes.

Using evaluation, measurement and verification (EM&V) tools to determine the savings from company programmatic DSM is critical. Rigorous savings estimates are important in order to ensure that ratepayers' investment in conservation programs is funding prudent and cost-effective energy efficiency programs.

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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?*

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?

PSE denies that any offsets to "unrecovered costs" could be found in increased loads from new or existing customers.[25] PSE does concede that "[t]raditionally, …growth in revenues from new and existing customers helped bridge the gap between revenues and costs created by input price inflation between historic test years and future rate years."[26] This is an important concession. In other words, PSE appears to agree with Public Counsel's point that ordinarily overall sales and revenue growth have obviated cost recovery problems between rate cases. PSE's argument is essentially that things are different now. PSE states in its comments that "[c]urrently, not only is use per customer not growing for PSE, its actually declining."[27] Read carefully, however, this statement does not state that overall PSE revenues from new and existing customers are declining, only that "use per customer" is falling (without specifying gas or electric service).

In fact, PSE's overall revenues from residential and commercial electric customers

[25] PSE Comments, p. 10. Avista acknowledges that offsets can exist if revenues from new customers exceed the cost to serve those customers or if average use per customer increases. Avista Comments, p. 9.
[26] PSE Comments, p. 10.
[27] PSE Comments, p. 10. No supporting reference is provided for the statement.

continue to grow according to publicly available data, as shown in Table 3 below. Revenues from industrial electric customers grew each year since 2005, with the exception of 2009, likely due to the economic recession. The data for natural gas, also shown in Table 3, reveals a similar trend, with declines for industrial in 2008 and 2009, and commercial in 2009.

Table 3. PSE Operating Revenues by Customer Class (2005-2009)

(in thousands)					
Electric	**2005**	**2006**	**2007**	**2008**	**2009**
Residential	$690,184	$788,237	$951,101	$1,046,897	$1,067,274
Commercial	$629,008	$702,754	$748,824	$800,879	$838,275
Industrial	$93,922	$103,043	$105,227	$106,092	$99,552
Gas	**2005**	**2006**	**2007**	**2008**	**2009**
Residential	$592,361	$697,631	$756,188	$766,799	$795,756
Commercial Firm	$234,342	$279,977	$306,357	$321,829	$306,357
Industrial Firm	$38,380	$43,994	$46,805	$42,530	$36,141
Sources: PSE 2009 Form 10-K, p.34, PSE 2007 Form 10-K, pp. 13, 19.					

Even PSE's statement about declining use per customer does not appear to be accurate. In PSE's last general rate case, after reviewing detailed usage data and information received in discovery, Public Counsel's expert witness concluded in testimony that:

> "[O]verall electric weather normalized sales to Residential and Commercial customer classes *increased* each year 2003 through 2008 in spite of PSE's increasing conservation expenditures. During this same time period the total number of Residential and Commercial customers also increased each year, which clearly contributed most significantly to the overall increase in electric energy sales to these classes of customers. That stated, even on a weather normalized usage per average customer basis, there is not a compelling case to be made that overall the conservation measures have significantly reduced

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average usage per customer." [28]

The analysis also concluded that "weather normalized usage per Residential and Commerical customer has remained relatively flat, if not slightly increasing over time, notwithstanding the energy conservation measures authorized by the Commission."[29]

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.

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?*
- *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.*

PSE opposes the use of an earnings cap, as do several other utility commenters. The utilities' rationale for opposing the cap is unclear. An earnings cap has the effect of preventing a utility from recovering funds under an incentive or decoupling mechanism if the

[28] Direct Testimony of James R. Dittmer, Exh. No. JRD-1CT, Docket Nos. UE-090704, UG-090705, p. 38:22-39:7.

[29] Direct Testimony of James R. Dittmer, Exh. No. JRD-1CT, Docket Nos. UE-090704, UG-090705, pp. 39:18-40:2.

recovery would cause the utility to overearn. This protects customers from paying excessive rates above the level determined to be fair, just and reasonable by the Commission under Washington statute.[30]

Public Counsel agrees with the observation by NWEC that "ultimately the most lucrative programs would be those that look good on paper while saving little or nothing in practice."[31] If customer payments under a mechanism are based on projected savings, but the savings are overstated, the company will receive revenue from the mechanism payments, and the revenue from the sale of the "unsaved" power as well.

Taken together, the utilities' policy recommendations are unfairly and significantly tilted against customers. The utilities favor very broad and over-inclusive decoupling designs, use of a future test year to base rates more on projections than actual costs, and establishment of an incentive program, all of which a utility could employ simultaneously and all of which customers would pay for. While these programs clearly reduce utility investor risk, utilities oppose any reduction of the return on equity to reflect the shift of risk to consumers, and oppose using an earnings cap to ensure that company does not overearn as a result of these new revenue streams. This inequitable approach is not in the public interest.

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?

[30] RCW 80.28.010(1); 80.28.020
[31] NWEC Comments, p. 10.

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?*

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?*

Most utility commenters argue that lost margin recovery has no effect on the incentive to control costs.[32] This makes no logical or economic sense. In the absence of decoupling (or lost margin or other automatic cost recovery mechanism), utility management must operate in the most efficient way possible, including through cost control, in order to earn a reasonable return at authorized revenue levels and cover company costs. An important component of that process is an effort to control or cut costs. If a decoupling or lost margin mechanism is in place, however, which automatically replaces revenues which decline for virtually any cause (as advocated by many decoupling proponents in this docket), the economic incentive to control costs is reduced.

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?*

[32] PSE Comments, p. 14; Avista Comments, p. 12; Northwest Natural Comments, p. 7.

PSE makes a legal argument that because the Energy Independence Act provides that a utility is allowed to recover "all prudently incurred costs associated with compliance with this chapter," a utility should be allowed to recover "unrecovered fixed costs." Public Counsel disagrees with this broad reading of the statute. The statute is more properly read, in the context of the entire Act, as referring to costs specifically related to the acquisition of renewable resources or the implementation of energy efficiency programs. The fixed costs which PSE refers to are part of the general costs of providing utility service and are defined by PSE as "expenses incurred by the utility that do not change in proportion to the volume of sales within the relevant period."[33] This encompasses all manner of costs for transmission, generation, and distribution which have no specific connection to the provision of energy efficiency or acquisition of renewables. The recovery of these costs is provided for through general ratemaking and it is a matter of debate as to whether the costs are in fact unrecovered at all. PSE cites no legislative history or other support for its interpretation.

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?*

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?*

[33] PSE Comments, p. 4. *See also* Public Counsel Comments, pp. 4-5 for another definition of fixed costs.

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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?

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?

Utility commenters have widely varying views on the value of "use-per-customer" as a metric. PSE does not believe it is a good metric.[34] Avista states it can be a useful metric but notes that other factors besides conservation can affect use per customer.[35] Cascade believes that it is the best metric.[36] PacifiCorp observes that the metric is not necessarily an indication of whether a customer is conserving energy. NWEC believes it is good metric. NEAA cautions that use-per-customer is not a very good metric because challenges to equity and measurement are "fairly intractable." NEAA also observes that failure to control adequately for massive changes such as the housing bubble or a recession can lead to excessive payments.[37] Public Counsel agrees with NEAA's comments on this issue. Public Counsel has consistently opposed decoupling mechanisms because they suffer from this same flaw.

19) Load Forecasting. Load forecasting is a key input for calculating conservation

[34] PSE Comments, p. 16.
[35] Avista Comments, p. 15.
[36] Cascade Natural Gas Corporation's Comments Regarding "Investigation of Conservation Incentives" (Cascade Comments), June 4, 2010, p 6.
[37] NW Energy Efficiency Alliance's Response to Consolidated Issues List (NEAA Comments), p. 9.

effects. How can load forecasting become more reliable? How does conservation get accurately incorporated into a company's load forecast?

In the Blue Ridge Consulting Services PSE ECIM Evaluation, Blue Ridge reviewed data from PSE regarding its sales forecasts. Blue Ridge stated in its report:

> Actual Sales to ultimate consumers exceeded the forecast amounts in each of the 5 years in the period covered by this review [2004 to 2008]. There are many factors (e.g. weather, economy, fuel prices, public awareness, and state and utility conservation incentives) that affect increases or decreases in electricity sales. However, in all years reviewed, Actual Sales exceeded Forecast. Blue Ridge did not have a forecast of off-system sales. Therefore, we could not assess how much of the displaced energy may have been sold to others. [38]

This review illustrates several risks involved in basing an incentive mechanism on estimates of reduced load allegedly due to conservation. First, the estimate of load loss may be overstated. Under a mechanism based on projected load losses, the company would receive incentive payments based on phantom "lost load," as well as earnings on the sales of the higher than projected amounts of power. Second, the loads are affected by many factors, not just conservation, so the incentive mechanism could result in unduly inflated payments.[39] Third, there is the potential for significant offsets resulting from the sale in the wholesale market of power not sold to PSE's own retail customers. These offsets could more than fully compensate for any loss of fixed cost recovery. According to Blue Ridge, PSE's wholesale sales increased 95 percent between 2008 and 2009. While no revenue figures were available, Blue Ridge identified this as a potential area of concern.

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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?

Support stated by utility commenters for independent evaluation, measurement and verification of energy efficiency programs is lukewarm at best. This is surprising, given the dramatic increase in the cost of these programs to consumers, the new legal requirements for conservation acquisition, and the discussion of possible incentives for achieving targets, EM&V is critical to the each of these.

While most utility commenters express a preference for doing the evaluation in-house, as NEAA appropriately points out, current EM&V practices are not uniform across utilities.[40] The variability across companies is problematic because it may contribute to erosion in confidence in and support for energy efficiency programs. Public Counsel agrees with NEAA that standard approaches to EM&V would benefit Washington and the region.[41] True independence and objectivity is crucial. Relying on in-house utility analysis place the burden on the UTC, its Staff, and other stakeholders to assess whether the evaluation was truly objective, accurate, and consistent with appropriate evaluation practices.[42]

PSE "reiterates that adoption of a decoupling mechanism would eliminate the

[38] Blue Ridge Phase I Report, p. 66.
[39] This is essentially the same point NEAA made in its comments on question 18.
[40] NEAA Comments, p 11.
[41] *Id*.

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need for elaborate EM&V requirements for the purpose of determining recovery of allowed revenues because it would not require calculation of separate conservation impacts."[43] This statement appears to reflect a view that there is no necessary connection between conservation and decoupling. This is a significant departure from the long-time rationale for decoupling offered by utilities and some conservation advocates who argue for decoupling as a means to advance conservation. This is the reason why decoupling is being discussed in this "conservation incentive" rulemaking. If PSE is now arguing that there is no need to actually measure or evaluate conservation outcomes in connection with decoupling, that is a new approach.

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?

NWEC comments that a decoupling adjustment or lost margin recovery " is not a cost, since it allows recovery of the allowed revenue requirement."[44] Public Counsel disagrees. As discussed above under question 1 regarding definitions, the decoupling mechanisms now in place in Washington for Avista and Cascade are not designed to provide the company's "allowed revenue requirement." They are instead based on average-use-per customer levels. These decoupling programs impose additional costs on customers beyond what is provided in a rate case. Avista most recent rate increase, which took effect in

[42] Public Counsel does not agree with NEAA that it would be adequate to use a third party evaluator to simply verify the work of in-house utility evaluators or engineering staff. *Id.*

[43] PSE Comments, p. 18.

January 2010, set revenues at a level to recovery all Avista's prudent and reasonable costs, plus a fair return on its investment.[45] For example, an Avista customer currently pays: (1) a basic monthly charge of $6 to be connected to the system; (2) electric and gas rates based on the amount of each commodity consumed; (3) additional payments to cover all costs of Avista's conservation programs; (4) a decoupling charge (applied to residential and small commercial natural gas customers under a separate tariff). Thus, from the customer perspective, the decoupling charge is an additional separate cost which is tied to the conservation programs.

Public Counsel believes that if the Commission determines that incentive or decoupling mechanisms are necessary to achieve conservation, then these costs should be taken into account in measuring the cost-effectiveness of conservation programs. A similar view was raised by NEEA.[46]

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?

There can be no serious debate from an economic perspective that stabilizing utility revenue via decoupling or lost margin recovery reduces risk, shifting it from shareholders to customers. The Commission has recognized this principle, as discussed in Public Counsel's initial comments. Further, it is equally well accepted that investment returns follow risk,

[44] NWEC Comments, pp. 14-15.

with lower risk investments providing lower returns. In the face of these economic verities, utilities continue to advocate for risk reduction via decoupling while simultaneously opposing any reduction in return to reflect that risk reduction. This improperly and inequitably requires ratepayers to pay shareholders for a level of risk which they are no longer undertaking. Such unadjusted returns are therefore excessive, and including the excessive return in rates violates the statutory requirement that rates must be "just, fair, reasonable and sufficient."[47]

The argument is made that no downward adjustment to return is required because there is no material impact (reduction) on business risk through the adoption of decoupling.[48] Utilities cannot with consistency argue, however, that conservation increases risks by seriously harming returns and cost recovery, while at the same time claiming that the supposed remedy – decoupling – has no material impact on business risk.

PSE comments that this issue can best be addressed in a rate case. It is true that a general rate case is the proper forum for making a company-specific downward adjustment to return. However, there is no reason why the Commission should not in this policy docket reaffirm the general principle that the utility's rate of return should be adjusted to reflect reduced risk when a decoupling, lost margin, or other similar risk shifting mechanism is adopted.

[45] Avista 2009 GRC, Order 10, ¶ 1.
[46] NEEA Comments, p. 12,
[47] RCW 80.28.010(1).
[48] PSE Comments, p. 19

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23) Incentive Rate of Return. Should a utility's rate of return be increased for sponsoring and administering conservation programs? If so, please explain. Should a utility earn a return on monies collected from ratepayers to fund its conservation programs? If so, please explain. Would the amount of energy efficiency offered by the utility increase under either of the above circumstances?

Public Counsel notes that utilities have not explained in their opening comments why they have not taken advantage of the rate of return "adder" provisions which have been available under Washington law for a number of years.[49]

Other Issues

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

NEEA provides a "straw" incentive proposal under which an absolute dollar amount would be earned in increments as conservation accomplishments increase.[50] Savings would be measured consistent with the way they are measured for I-937 using what NEAA refers to as "gross savings." The concept of an incentive based on a dollar amount may be worth considering. However, the use of "gross savings" is problematic. In some instances, conservation will be achieved, but not as a result of direct utility actions. For example, the Northwest Power and Conservation Council considers "naturally occurring conservation" (conservation that would have happened regardless of any action by utilities or others) and conservation achieved due to improved codes and standards. In the latter example, the savings largely apply to new load that is using less than would have been used in the absence of new

[49] RCW 80.28.025
[50] NEEA Comments, pp. 13-14.

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codes and standards. Nevertheless, the utility is still serving new load and collecting additional revenues. For these and other reasons, it is important that any incentive mechanism should only recognize and reward savings that were directly impacted by utility actions, rather than "gross savings."

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