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PUGET SOUND ENERGY
The Energy To Do Great Things
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June 18, 2010

Mr. David W. Danner
Executive Director and Secretary
Washington Utilities and Transportation Commission
1300 South Evergreen Park Drive S.W.
P.O. Box 47250
Olympia, WA 98504-7250

Subject: **Docket No. U-100522**
Examination of Whether New Regulations are Needed to Govern Conservation Incentive Mechanisms or Address Declines in Revenues Due to Company-Sponsored Conservation or Other Causes of Conservation.
Comments of Puget Sound Energy, Inc.

Dear Mr. Danner:

Puget Sound Energy, Inc. ("PSE" or the "Company") appreciates the opportunity to participate in the Commission's examination of whether new regulations are needed to govern conservation incentive mechanisms or address declines in revenues due to company-sponsored conservation or other causes of conservation. In response to the Commission's Notice of Opportunity to File Written Comments dated May 13, 2010 in Docket No. U-100522, PSE offers the following response to comments made on June 4, 2010.

RESPONSE TO COMMENTS

Issue 1: Definitions

Issue 1: Definitions		
Party	**Statement**	**Response**
Public Counsel	"decoupling can provide additional revenue for a utility company even where overall sales and revenues are increasing and without regard to whether the utility rate of return is impaired"	This is not any different from existing rate designs. Decoupling can also produce LESS revenue than under existing ratemaking practice.
Public Counsel	"The Commission has recognized that in this regard decoupling 'risks over-earning by the company and over-paying by the customers.'"	It is not clear why tying revenues to customer growth, which is stable, more likely leads to over-earning than tying revenues to energy sales, which can far exceed those levels used to set rates.
Public Counsel	"Notwithstanding decades of declines in average natural gas use per customer, data for 1999-2008 show the average return on equity for natural gas utilities has been a healthy 12 percent, and there is no evidence of shortfall in cost recovery."	Nearly all of the utilities listed in the cited testimony of Glenn Watkins have a decoupling mechanism, straight fixed-variable rates, rate stabilization mechanisms, weather normalization mechanisms and/or other revenue normalizing mechanism. This might explain the healthy returns.
NWIGU	"First, customer growth could more than offset lower per customer usage between rate cases. If customer growth is left to the benefit of shareholders, while the risk associated with decreases in per customer usage is shifted to reduce risk to the shareholder as well, the current regulatory balance is tipped inappropriately rewarding potential excessive returns to shareholders."	If new customers came without any new costs, this might be true. However, in reality, utilities like PSE experience additional costs to serve new customers. In fact, the intent of PSE's line extension policy is to ensure that the cost to serve new customers is the same as the cost to serve existing customers. As a result, the revenues associated with new customers are fully offset by their associated cost of service.
ICNU	"Decoupling also has the practical impact of shifting 'some degree of risk from the company to its customers' because the utilities are guaranteed a certain amount of earnings and cost recovery regardless of their actual level of electricity sales."	Decoupling does <u>not</u> guarantee "a certain amount of earnings." Furthermore, customers also experience <u>less risk</u> under decoupling by not being subject to the risk of paying more than what is required to cover the fixed cost associated with their electric or gas service.

Issue 2: Recovery of Program Costs

Issue 2: Recovery of Program Costs		
Party	**Statement**	**Response**
NWIGU	"If the rates are adjusted annually, so called lost margin from legitimate conservation expenses are trued up and likely offset by efficiencies and customer growth."	This statement ignores that lost margins are a direct result of regulatory lag. If, in fact, utilities' rate year conservation were reflected in rates, then lost margins would be "trued up." As it stands now, on the first day new rates go into effect, 18-19 months of lost margin from incremental conservation savings has already accrued.
The Energy Project	"Programs in Vermont, Wisconsin and Oregon that have removed the conservation responsibility to a third party whose reason for being it [sic] to promote conservation appear to be quite successful."	Creation of a third party entity to administer conservation programs does not eliminate the under-recovery of fixed costs by utilities due to those programs. Each of these states has decoupling to address recovery of fixed costs and remove disincentives for additional conservation.
ICNU	"Other states have taken the approach of establishing a separate organization that is responsible for conservation programs."	Utilities are still subject to unrecovered fixed costs from conservation, even in states where a separate organization is responsible for programs. To PSE's knowledge, every state (other than Maine) that has established a separate organization that is responsible for conservation programs also allows decoupling for utilities in the state.

Issue 3: Statement of Issue

Issue 3: Statement of Issue		
Party	**Statement**	**Response**
Public Counsel	"Blue Ridge added the calculated lost margin in 2007 and 2008 to the realized return and found that the rate of return on electric rate base would have only increased from 8.25 percent to 8.29 percent in 2007 and from 6.51 percent to 6.71 percent in 2008."	Public Counsel's observations are taken out of context and misleading. The noted impact on returns reflect only the conservation performed in 2007 that affected 2007 returns, and conservation performed in 2007 and 2008 that affected 2008 returns. As shown in Attachments B and C to PSE's direct comments in this proceeding, conservation achieved since

		October 2004 must be included to fully reflect the lost margins experienced in 2007 and most of 2008. At the present levels of conservation achievement, PSE estimates that the resulting lost margin-related reduction in its ROE is approximately 75 basis points. The reduction in distribution related ROE is far greater.
CMS	"To the extent utilities have made it a practice to file annual rate cases, use of a new test year should obviate the need for any attrition study or allowance. Each successive test year should be based on then-current sales volumes."	Using historic test year sales volumes will by definition not reflect the conservation that occurs between that time and when rates go into effect.
ICNU	"all of which provide the utilities with significant protection against regulatory lag"	Even with those items, regulatory lag on PSE's delivery system has been, on average, 32 months during the period between 2006 and 2009.
ICNU	"The utilities have never provided quantifiable evidence that demonstrates that the amount of lost margins…"	PSE has provided quantifiable evidence of the amount of lost margins due to conservation publically numerous times over the past year: to conservation stakeholders at the September 15 CRAG meeting; as data responses and testimony in the 2009 general rate case; contained in the Blue Ridge report; and as part of our comments submitted on June 4.

Issue 4: Magnitude of Risk

Issue 4: Magnitude of Risk		
Party	**Statement**	**Response**
ICNU	"Distinguishing between lost margins because of conservation and other factors is necessary 'to avoid guaranteed recovery of lost margin that would occur should lost margin from other causes be included in the mechanism.'"	If the intent of a mechanism is simply to address the lost margin associated with utility-sponsored conservation, then a lost margin recovery mechanism would be a more straight-forward and transparent approach.
ICNU	"Utilities should not be allowed to benefit from a decoupling program to account for those conservation resources the utilities are already	This comment ignores RCW 80.28.020, which requires rates authorized by the Commission to be just, reasonable, and compensatory. Just as utilities are

	going to invest in regardless of whether there is a decoupling program. "	generally allowed to recover the cost of expensive new environmental requirements through rates, so must they be allowed to recover costs that they are otherwise prevented from recovering by requirements to promote conservation. There is currently a disconnect between RCW 19.285 and RCW 80.28.020.
ICNU	"Ratepayers should not be required to shoulder the risks and higher costs associated with decoupling programs…"	ICNU fails to identify what new risk customers shoulder as a result of such mechanisms. Indeed, customers shoulder less risk of paying a utility more than required to cover its costs under a decoupling mechanism than under current rate designs.
CMS	"If Washington State were to increase the tax on gasoline and consumers responded by purchasing more energy efficient vehicles, should the state then ensure that auto manufacturers earn their full profit margin on cars with the lowest gas-mileage ratings?"	There is no connection between this analogy and the issues at hand. Auto manufacturers are not regulated by the WUTC. Further, lost margin recovery does not "ensure" that utilities "earn their full profit margin."
ICNU	"The Commission should also require proponents of decoupling programs to provide detailed, empirical evidence of the amount of lost margins and their specific causes."	PSE has provided quantifiable evidence of the amount of lost margins due to conservation publically numerous times over the past year: to conservation stakeholders at the September 15 CRAG meeting; as data responses and testimony in the 2009 general rate case; contained in the Blue Ridge report; and as part of our comments submitted on June 4.

Issue 5: Rationale for Incentive

Issue 5: Rationale for Incentive		
Party	**Statement**	**Response**
Public Counsel	"as a practical matter, Washington's major regulated utilities are in an era of frequent rate case filings. PSE has filed 9 rate cases since 2001. Avista Utilities is currently prosecuting its fifth rate case since 2005.	The frequency of these filings (where new cases are filed only a few months after new rates go into effect) should serve to highlight the possibility that the current regulatory system is not addressing utilities' costs recovery needs.

	These nearly annual filings by definition allow the utility to request relief for any failure to earn a reasonable rate of return, and to receive a rate increase if needed to remedy the problem. "	
Public Counsel	"Washington law has for many years provided that a utility may receive a "bonus" rate of return for conservation investments. RCW 80.28.025. Washington's regulated utilities have not made use of this provision although conservation expenditures have risen dramatically. This would seem to provide evidence there is not a serious "rate of return" issue, since basic laws of economics would be expected to motivate recourse to the statute if a problem existed."	PSE currently expenses conservation measures. RCW 80.28.025 implies that a utility can receive a "bonus" rate of return on capital investments.
The Energy Project	"The more apropos question might be whether an incentive is as attractive as decoupling/lost margin recovery to utilities and why not?"	An incentive is not meaningful unless the underlying lost margin issue has first been addressed. PSE's election not to renew its conservation incentive mechanism illustrates this.
ICNU	"Conservation incentives may also be a sufficient substitute for decoupling programs. "	An incentive is not meaningful unless the underlying lost margin issue has first been addressed. The fact that PSE elected not to renew its conservation incentive mechanism illustrates this. A mechanism that facilitates the full recovery of unrecovered fixed costs due to conservation is not the same as a mechanism that facilitates a reward for exceeding a commission-approved conservation target.
CMS	"Currently, utilities have two businesses. They sell energy and they also use ratepayer money to implement conservation measures that have the natural consequence of cutting their energy sales volumes. These two businesses are inherently contradictory."	These businesses are only made contradictory due to the ratemaking practices that have not kept pace with more modern policy realities (i.e., recovering fixed costs through variable charges). Something as simple as straight fixed-variable rate design would go a long way to eliminating these

		contradictory business realities. Other states have not found these two businesses to be contradictory. Fourteen states have approved both incentive mechanisms and mechanisms to address unrecovered fixed costs (or lost margins or lost revenues) for electric utilities, while seven states have done the same for natural gas utilities. Several other states have approval of these mechanisms pending.
ICNU	"Utilities should not be allowed to benefit from a decoupling program…"	A mechanism that facilitates the full recovery of unrecovered fixed costs due to conservation is not the same as a mechanism that facilitates a reward for exceeding a commission-approved conservation target, and therefore should not be referred to as a "benefit".

Issue 6: Categories of Lost Margin Due to Conservation

General comments: Conservation can occur from many sources. For example, the conservation potential assessments for utility IRPs frequently include conservation from codes and standards and market transformation, as well as traditional utility programs. The regional power plan prepared by the Northwest Power and Conservation Council takes a similar approach. There is also a growing trend within the utility industry to encourage energy-saving actions through education and information efforts. PSE agrees with NWEC that utilities should support these efforts. Excluding non-programmatic energy savings from any decoupling or lost margin recovery mechanism creates a disincentive for utilities to encourage other sources of savings beyond traditional programs. Accurately measuring and attributing energy savings for each of these categories is indeed daunting. However, as NWEC points out, "[f]ull decoupling does not rely on these calculations for its result".

Issue 6: Categories of Lost Margin Due to Conservation		
Party	**Statement**	**Response**
Public Counsel	"any such incentive should be limited in its design to be proportional to the lost margins that can be attributed to utility-sponsored DSM programs"	This diminishes the value of supporting codes and standards, educational programs, and regional market transformation, which the Commission currently allows utilities to fund. Decoupling eliminates the need for separate measurement of each category.
ICNU	"Only the lost margins associated with company sponsored	See response to Public Counsel comment above.

	conservation programs should be allowed."	
ICNU	"limit the recovery of lost margins to only those conservation programs that the utilities would not otherwise invest in."	This suggestion ignores that margins have been and will continue to be lost at an increasing rate, and that utilities are suffering cumulative harmful effects from conservation efforts. Adopting this suggestion would also add to the complexity of attempting to parse out the effects of different categories of conservation by creating yet another category to be measured. More importantly, this is addressing a precedent that may be obsolete, namely that decoupling or lost margin recovery mechanisms can only be justified if utilities do more conservation than they are already doing without them.

Issue 8a: Offsets

General comments: If the matching principle is invoked, then it needs to be applied consistently. If underlying load growth is taken away from utilities then it will be impossible for rates based on historic test year costs to ever produce just, reasonable, and compensatory rates as required by RCW 80.28.020.

Some parties have commented that "found margins" or "offsets" from new customer loads and increased load from existing customers should be netted out of any lost margin calculation, while at the same time advocating that only utility program load reductions be included. Most of these load reductions occur for various reasons that have nothing to do with conservation, such as employment levels and disposable income. If "found" margins from all sources are to be included, then conservation from all sources should also be considered. Moreover, some of these "found" margins are accompanied by costs, as recognized by NWEC and the Energy Project. As noted in Issue 6, the challenge of measuring and attributing impacts to a myriad of factors is considerable. True decoupling would capture both the lost margins from all sources of conservation as well as all "found" margins, without requiring these complex analyses.

Issue 8a: New Customers		
Party	**Statement**	**Response**
Public Counsel	"To not include the growth in sales volume and revenues being experienced by a Company from new customers violates the	Likewise, to fail to include the <u>cost</u> associated with these new customers would violate the matching principle.

	matching principle and has the effect of unreasonably increasing the decoupling deferrals that are recorded by the Company."	
ICNU	"As recognized by the Commission, certain conservation programs can actually result in increased, albeit more efficient, electricity usage."	To PSE's knowledge there is no evidence to support this assertion.

Issue 8b: Additional Load from Existing Customers		
Party	**Statement**	**Response**
Public Counsel	"Recovery of lost margins should also be offset due to additional load for existing customers. It is unreasonable to consider only one driver of changing sales volumes, such as lost energy sales stemming from utility conservation measures implemented, while making no other adjustments to account for the other variables that influence sales and may lead to increased customer usage or "found margins" from things like economic conditions, additional appliances being added to a home, etc."	If underlying load growth is taken from utilities, it is highly unlikely that rates based on historic test year costs will ever produce rates that are just, reasonable, and compensatory in a future rate year. Traditional rate designs were premised on the long-held observation that use per customer was increasing. This, along with productivity improvements, helped bridge the gap between historic costs and future costs. To be fully compensatory, in the absence of growing use per customers, productivity growth must fully offset cost inflation. This is unrealistic.
ICNU	"including load increases that may result from new conservation programs"	No empirical evidence has been provided to prove this assertion.

Issue 9: Industrial Customers

Issue 9: Industrial Customers		
Party	**Statement**	**Response**
ICNU	"decoupling can have the practical effect of discouraging industrial customers from reducing their	Since utilities have traditionally had to recover a portion of their fixed costs through variable charges, the marginal

	usage because they do not reap the full value of any savings associated with lower electric usage…" "Decoupling can also send inappropriate and incorrect price signals, which can discourage customer financed conservation…" "Decoupling can be a powerful disincentive for customers to invest in their own conservation programs if the reward for reducing electricity usage is higher future rates."	"value" to the customer is overstated. Customers expect they should be able to avoid the fixed costs being recovered through variable charges, even though these costs will remain. This illustrates the failure of this traditional approach to utility rate design. It is not clear what is meant by "full value of any savings". This seems to imply that large customers are keeping all of the value of those lost margins and are not sharing that value with other parties. No empirical evidence has been provided that proves that decoupling sends inappropriate or incorrect price signals. The fact that 21 state regulatory commissions have already approved decoupling suggests that decoupling is neither an incorrect price signal nor an inappropriate price signal.
ICNU	"Decoupling programs may also not be necessary for large industrial customers as their electricity costs are a significant cost of business, and these price sensitive customers typically aggressively pursue their own and their utilities' cost- effective conservation and energy efficiency programs."	This statement demonstrates that large industrial customers are contributors to the lost margin issue. If large industrial customers are aggressive participants in the utility-sponsored programs, then they contribute to the lost margin problem.
ICNU	"Decoupling for industrial customers can have a myriad of negative impacts, including potentially discouraging and penalizing customers for engaging in conservation programs."	It is not clear how customers are penalized if they only pay their fair portion of the fixed costs that the Commission has already approved for recovery in rates for those customers?

Issue 10: Other Characteristics of Incentive Mechanism

Issue 10b: Incentive Targets Different than EIA (I-937)		
Party	**Statement**	**Response**
Public Counsel	"conservation targets developed	Distribution efficiency and production

	for these utilities under the EIA may include conservation sources that are not tied to utility sponsored conservation programs, such as production and distribution efficiency. Therefore, targets tied to an incentive mechanism for electric utility may be different than those developed under EIA as these would exclude sources not tied utility-sponsored conservation programs."	efficiency should not be treated differently, particularly for fixed cost recovery from reduced loads. These efficiency programs would provide the same long term customer benefits of lower energy supply costs and reduced greenhouse gas emissions as other programmatic conservation. Omitting these resources sends a signal that they are somehow less valuable and discourages utilities from aggressively developing them.
Issue 10d: Earnings Test		
Party	**Statement**	**Response**
The Energy Project	"If the point for any of these mechanisms is to ensure the sponsorship of energy efficiency doesn't deny the utility what it needs for full revenue recovery, there needs to be an over earnings test. How does that occur without a full general rate case?"	Earnings tests do not require a general rate case.

Issue 12: Impact on Low-Income Households

Issue 12: Impact on Low-Income Households		
Party	**Statement**	**Response**
The Energy Project	"The fact that a low-income household has generally lower consumption than regular residential households, because they live in smaller dwellings on the whole and have fewer toys to play with, might suggest that levying the cost on a volumetric basis might be more fair. "	This is not the case for PSE's residential electric customers. PSE's bill-assisted customers in fact consume **more** than PSE's average residential electric customer.
CMS	"If responsibility for conservation is transferred to an independent third party, then the issue about utility incentives disappears and, with it, the risk of adverse impact on low-income customers."	Unfortunately, this still leaves unaddressed the fundamental problem of recovering fixed costs through volumetric charges. Further, all states that have transferred responsibility for conservation programs to an independent third party have also authorized decoupling for affected utilities.

Issue 13: Impact on Utility Incentives

Issue 13: Impact on Utility Incentives		
Party	**Statement**	**Response**
Public Counsel	"recovery of lost margins reduces the incentive for the utility to control costs."	This is untrue. Once rates are set, utilities will always have an incentive to control costs, because by doing so they increase their expected returns.
ICNU	"Decoupling programs provide a disincentive to the utilities to control their costs and improve customer satisfaction"	This is untrue. Once rates are set, utilities will always have an incentive to control costs, because by doing so they increase their expected returns.

Issue 14: I-937 Requirements

Mechanisms that provide incentives for conservation must be distinguished from mechanisms (such as decoupling) that alleviate the problem of unrecovered fixed costs. Mechanisms to address unrecovered fixed costs remove *disincentives* to promote conservation, but this does not make them "incentive" mechanisms. Rather, they constitute appropriate regulatory treatment in light of the requirement that rates be just, reasonable, and compensatory.

With respect to incentive mechanisms, PSE agrees with earlier comments made by NWEC:

> *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. (NWEC, p.1)*

With respect to mechanisms to address unrecovered fixed costs, it is important to consider the legal mandate of RCW 80.28.020, which requires the Commission to fix rates that are just, reasonable, and compensatory. These statutory requirements must be taken into account when addressing unrecovered fixed costs.

Issue 14: I-937 Requirements		
Party	**Statement**	**Response**
Public Counsel	"There is not ordinarily an expectation by individuals or businesses that they will receive special additional compensation for following the law."	This comment ignores the mandate in RCW 80.28.020 requiring rates authorized by the Commission to be just, reasonable, and compensatory. Just as a utility is generally allowed to recover the cost of expensive new environmental

		requirements through rates, so too should it be allowed to recover costs that it is otherwise prevented from recovering by requirements to promote conservation. There is currently a disconnect between RCW 19.285 and RCW 80.28.020. The expectation of the law is that just, reasonable, and compensatory rates will compensate utilities for all the costs of doing prudent conservation.

Issue 15: Incentive to Exceed I-937

Issue 15: Incentive to Exceed I-937		
Party	**Statement**	**Response**
ICNU	"There does not appear to be a need for decoupling programs in Washington. The utilities have a legal mandate from I-937 to invest in all cost-effective, reliable and feasible conservation."	This statement confuses incentive mechanisms with mechanisms that address declines in revenues (or margins, or unrecovered fixed costs). A mechanism that facilitates the full recovery of unrecovered fixed costs due to conservation is not the same as a mechanism that facilitates a reward for exceeding a commission-approved conservation target. This comment ignores the mandate in RCW 80.28.020 requiring rates authorized by the Commission to be just, reasonable, and compensatory. Just as a utility is generally allowed to recover the cost of expensive new environmental requirements through rates, so too should it be allowed to recover costs that it is otherwise prevented from recovering by requirements to promote conservation. There is currently a disconnect between RCW 19.285 and RCW 80.28.020. The expectation of the law is that just, reasonable, and compensatory rates will compensate utilities for all the costs of doing prudent conservation.
Public Counsel	the statutory target is the identification of all achievable, cost-effective, feasible conservation. By definition any	The statutory "target" is established based on *projected* conservation potential pursuant to RCW 19.285.040(1)(b) and WAC 480-109-010. The minimum

	additional conservation achieved beyond this would not be cost-effective.	biennial target required by law is a pro rata share of electric utilities' ten-year projected conservation potential. This process does not capture new cost-effective measures that were unforeseen at the time of the projection. Also, some retrofit efficiency opportunities may be able to be acquired at a faster pace than was originally projected, if market conditions are more favorable than expected.

Issue 22: Mechanism Effects on Allowed ROE

Issue 22: Mechanism Effects on Allowed ROE		
Party	**Statement**	**Response**
Public Counsel	"Decoupling or lost margin mechanisms shift risk from shareholders to ratepayers by stabilizing utility revenue, effectively guaranteeing a certain level of cost recovery."	It is not clear from Public Counsel's comments what new risk customers would shoulder as a result of such mechanisms. Indeed, customers shoulder less risk of paying a utility more than required to cover its costs under a decoupling mechanism than under current rate designs.
ICNU	"Decoupling shifts the risk of changes in loads and sales from utility shareholders to customers"	See response above.
ICNU	"The adoption of any decoupling or incentive program should include a downward adjustment in the utility's rate of return to reflect the utility's lower risk profile."	Again, a decoupling program works both for ratepayers and shareholders so does not constitute a shift in risk to support a downward adjustment in the utility's rate of return. Similarly, an incentive program that results in a reduced return is not much of an incentive.
ICNU	" The existence of decoupling allows the utilities to protect their earnings in the event of reduced sales, improves the opportunity to earn their authorized return on equity, and reduces its overall operating risk."	A mechanism that facilitates the full recovery of unrecovered fixed costs due to conservation does not "allow the utilities to protect their earnings."

Issue 24: Other Issues

Issue 24: Other Issues		
Party	**Statement**	**Response**
ICNU	"Washington's electric utilities…are nationally recognized as leaders in conservation investments"	It is likely that if financial disincentives related to conservation are not removed, Washington State will not remain a leader in conservation. Fourteen states have approved both incentive mechanisms and mechanisms to address unrecovered fixed costs (or lost margins or lost revenues) for electric utilities, while seven states have done the same for natural gas utilities. Several other states have approval of these mechanisms pending. PSE is not top ranked using all available metrics, especially on the gas side. Top performance is a moving target as many leading states have recently increased their conservation goals. RCW 80.28.020, which requires rates authorized by the Commission to be just, reasonable, and compensatory, cannot be ignored. There is currently a disconnect between RCW 19.285 and RCW 80.28.020 in the regulatory model in the state of Washington.

PSE appreciates the opportunity to present its viewpoint on this issue list and looks forward to further discussions on this topic. Please direct any questions regarding these comments to Eric Englert at (425) 456-2312 or the undersigned at (425) 462-3495.

Sincerely,

/s/ Tom DeBoer

Tom DeBoer
Director – Federal & State Regulatory Affairs