

**BEFORE THE
WASHINGTON UTILITIES & TRANSPORTATION COMMISSION**

<p>IN RE: WUTC V. PUGET SOUND ENERGY DOCKET NOS. UE-060266 & UG-060267</p>	<p>POST-HEARING BRIEF OF NW ENERGY COALITION</p>
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October 30, 2006

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I. INTRODUCTION: IT IS NECESSARY TO ALIGN CUSTOMER AND SHAREHOLDER INTERESTS TO INVEST AGGRESSIVELY IN COST-EFFECTIVE CONSERVATION

1. Cost-effective conservation must be our highest priority resource due to its low cost and environmental benefits. However, traditional utility regulation encourages increased energy use and discourages economical investments to reduce customer use. Therefore it is necessary to align customer and shareholder interests to invest aggressively in cost-effective conservation. (e.g., Exhibit 561 page 6:1-3)

2. Either direct incentives or decoupling can be structured to align customer and shareholder interests, and both merit implementation on a pilot basis. PSE proposed pilots of both a gas decoupling mechanism and an electric efficiency incentive program. Since decoupling more fully aligns customer and shareholder interests than a direct incentive program (e.g., Exhibit 562, page 13:7-9), the NW Energy Coalition (“the Coalition”) recommends that the more comprehensive incentive should be implemented where there are greater barriers to investments in energy efficiency--the gas market.

3. During both rounds of these proceedings, the Coalition has made the case for implementation of a decoupling mechanism for the gas side of Puget Sound Energy so long as it is designed correctly and accompanied by concrete commitments and incentives for utility conservation programs (Exhibit 502, especially Conclusion at page 21, and Exhibit 504). The Coalition has outlined the adjustments that would have to be made in the Company’s proposal for it to

be considered just and reasonable (Exhibit 502, pages 22:14-25:2). In addition we have shown that, especially with decoupling, customer charges should be reduced to a minimum (Exhibit 502, pages 8-9); and therefore, the Company's late-introduced proposal to raise that charge to \$17 for residential customers should be rejected. This last proposal should also be rejected because it was unexpectedly introduced at rebuttal (Exhibit 31, page 5:3-4, Exhibit 186, page 5:5-10), leaving little opportunity for Parties to present counter-evidence.

4. We recommend a more limited direct conservation incentive program for PSE's electricity business and are willing to modify our initial proposal: either substituting the penalty levels outlined in PSE's modified proposal (Exhibit 382, page1) and/or calculating the incentives in a manner consistent with Staff's proposal but at a level more similar to that proposed by the Coalition.
5. Finally, please note that in this Brief the term "decoupling" is used generically to mean a mechanism such as proposed by PSE that assures margin recovery for both weather and non-weather changes in per-customer usage.

II. DECOUPLING IS BENEFICIAL TO PSE AND ITS CUSTOMERS

A. DECOUPLING REMOVES THE COMPANY'S INCENTIVE TO ENCOURAGE LOAD GROWTH.

6. All parties that addressed this issue (the Staff, Coalition and PSE) agreed that a decoupling mechanism will remove the Company's current disincentive to support conservation by restoring lost margins that it would otherwise incur when

per-customer usage declines. (Exhibit 561 page 6:1-3, Exhibit 502, page 2:17-19, and Exhibit 21, pages 27:15-28:4)

B. DECOUPLING IS EXPECTED TO LOWER THE COMPANY'S COST OF CAPITAL.

7. Staff witness Hill's unrebutted testimony (Exhibit 531C, page 62) estimated that PSE's decoupling mechanism would reduce its revenue requirement by approximately \$14 million annually (approximately a 50 basis point reduction in the cost of capital). PSE witness Morin's rebuttal testimony supports this result (Exhibit 315, page 94:10-12). This benefit would certainly be passed along to customers over time as the Coalition recommended (Exhibit 502, pages 18:3-21:7), or it could immediately be passed through to customers in this proceeding. The reason for the expected cost saving is that decoupling reduces the Company's risk of collecting its approved margins—primarily due to the weather adjustment.

C. COST SAVINGS FROM PSE'S WEATHER ADJUSTMENT MECHANISM ARE EXPECTED TO BE LARGE ENOUGH TO OFFSET MOST SURCHARGES AND FUND ITS GAS CONSERVATION PROGRAMS.

8. This estimated savings from PSE's decoupling mechanism (\$14 million annually) discussed above should be compared to an analysis offered by Staff witness Steward (Exhibit 569, page 11:1-3). Ms. Steward used PSE's data to demonstrate the effect of decoupling under PSE's proposed rates with and without the weather adjustment for the past three years. These years experienced

relatively warm, above-normal weather, and would thus have resulted in a surcharge if decoupling had been in place. The surcharges for those three warm years averaged \$12.9 million per year, notably less than the revenue requirement reduction due to the \$14 million cost of capital reduction estimated by Hill and Morin, above. While these rate adjustments were illustrative only, one can draw a similarly illustrative conclusion: most warm-year adjustments will be offset to a great degree, if not fully, by the Company's reduction in its cost of capital. When normal or cold weather occur, there will be a large net benefit to customers. On average, over a multi-year period, it is reasonable to expect that weather adjustments in rates pursuant to a decoupling mechanism will tend to zero.

9. The \$14 million in annual savings could also be compared to the estimated cost of PSE's gas conservation programs. PSE's two-year (2006-2007) conservation budget to deliver the 4.2 million therm stretch goal totals \$12.2 million, or \$6.1 million per year (Exhibit 502, page 14:12). The Coalition recommends (Exhibit 502, page 11:5) that PSE be allowed full (100%) margin recovery through decoupling if it meets 150% of this stretch goal. Even at this level of conservation investment, the \$14 million cost of capital savings from the weather adjustment is more than sufficient to cover all of the Company's conservation costs.

10. For these reasons, we urge the Commission to approve the weather-adjustment component of PSE's decoupling proposal. The risk-reduction value of

the weather adjustment provides cost savings that will counteract most or all of any surcharge, and overall make decoupling a huge net-benefit for customers.

D. DECOUPLING REDUCES THE VOLATILITY OF CUSTOMERS' BILLS.

11. As can be seen in Ms. Steward's Exhibit 563 referred to in the previous section, weather-related changes in usage are responsible for the greater part of customers' bill volatility. A decoupling mechanism that includes a weather adjustment reduces bill volatility by acting as a perfect hedge against weather-induced changes in usage (Exhibit 502, page 7:6-18). However, unless the adjustments are made in the customer's bill in real time—as with NW Natural's Weather Adjusted Rate Mechanism (WARM)—customers will face an unintended adverse rate impact roughly one in four years when a warm winter is followed by a cold one (Exhibit 504, page 11:1-9). For that reason we recommended a revenue adjustment cap of about 3% unless PSE can implement a monthly adjustment mechanism.

12. It should be noted that Staff's only objection to including a weather adjustment as part of a decoupling mechanism is the possibility of multi-million dollar deferrals (Exhibit 569, page 12:4-10). In fact, Steward states that she was not opposed to a weather adjustment mechanism—"stabilizing both the customer's bill and PSE's earnings could be a win-win situation"—she only opposes the Company's proposed mechanism because it can create multi-million dollar deferrals (Exhibit 569, pages 11:14-12:10). Ms. Steward agreed that if PSE's billing system could handle a mechanism such as NW Natural's that

eliminates deferrals due to weather (there would still be deferrals for non-weather changes, but of much smaller size), it would merit serious consideration. (Hearing Transcript, Volume VI, page 744: 19-21.)

13. Even Public Counsel’s expert witness Brosch, while opposing decoupling in general, agreed in the hearing that a weather adjustment has “merit.”

Q. (Glaser) So, given that a stand-alone weather adjustment seems to meet most or all of the criteria you and the Commission have set out for adjustments between rate cases, and it would result in lower rates, so would you favor a stand-alone weather adjustment even if the Commission rejected other parts of decoupling?

A. (Brosch) I think there is merit, more merit in a weather normalization adjustment in isolation than there is in any of the decoupling proposals in the case. (Hearing Transcript, Volume IV, page 672: 22-25.)

14. The Coalition urges the Commission to approve decoupling with the current weather adjustment and direct the Company to quickly investigate whether its billing system can handle within-month adjustments. And if PSE’s billing system can handle within-month adjustments, it should be encouraged to file a proposal to move to or incorporate such a design as soon as practicable. The weather adjustment provides the savings that can be expected to eliminate most or all rate increases created by the decoupling mechanism, as well as paying for PSE’s gas efficiency programs except in the warmest years when customers would face low bills in any case. Therefore, these savings should not be sacrificed to a “partial” decoupling mechanism—especially if the Company’s billing system can accommodate a within-month adjustment.

III. CONTRARY TO ASSERTIONS OF PUBLIC COUNSEL, DECOUPLING IS NOT HARMFUL TO CUSTOMERS IF PROPERLY IMPLEMENTED.

A. DECOUPLING DOES NOT PROVIDE AN UNWARRANTED “WINDFALL” TO THE COMPANY.

15. Public Counsel witness Michael Brosch asserts, with little evidence, that the Gas Revenue Normalization Adjustment (GRNA, or “decoupling”) proposed by the Company “promises higher prices paid by consumers,” labeling it a regulatory “sweetener” (Exhibit 506C, page 18:10). Brosch attempts to substantiate this claim by showing that the Company would collect, “positive additional revenues through the GRNA,” (Exhibit 506C, page 36:18) and that the GRNA favors shareholders by, “ignoring the fact that margin revenues in total are growing due to customer growth.” (Exhibit 506C, page 37:6-7). The flaw in this argument is that Brosch mistakes an increase in revenue with an increase in profit (net revenue). Additional customers do generate additional revenue, but they also create additional costs. Thus without further analysis, inclusive of the effect of the Company’s line extension policy, it is impossible to know whether the GRNA is sweet or bitter for the Company. In fact, only two pages after making his claim that new customers create unwarranted shareholder profit, Brosch completely contradicts his own argument: “I would encourage the Commission to **not accept any unproven assumptions** regarding whether or not customers added to PSE’s gas delivery system between rate cases are financially harmful or beneficial to the Company.” (Exhibit 506C, pages 38:17-39:3, emphasis added) We urge the Commission to follow Brosch’s own advice by not giving any weight to his argument that the Company benefits from new customers due to the GRNA.

16. The Coalition recognizes the empirical underpinning of this discussion in its recommendation (Exhibit 502, page 17:12-19) to use a different margin revenue baseline for new customers based on analysis of incremental revenues and costs. Staff witness Steward also recommends a way to modify how new customers should be treated that would be an acceptable surrogate for our proposal (Exhibit 561, page 15:5-18), though perhaps not as accurate as a modification based on detailed analysis.

B. DECOUPLING DOES NOT SHIFT UTILITY RISKS TO CUSTOMERS.

17. Public Counsel witness Brosch also argues that decoupling shifts “sales volume risk” from the utility to customers (Exhibit 506C, page 18:12). He fails to understand that the risk of over- or under-recovery of margins is currently borne by both the Company and customers.

18. Our witness, Mr. Weiss, demonstrated that decoupling does not shift this risk, it instead swaps the risk, reducing it for both parties (Exhibit 502, page 7:6-14). And, just as important, Mr. Brosch fails to recognize the benefit to customers of removing risk from the Company. He has failed to recognize that risk both: (a) costs customers money (i.e., a higher cost of capital), and; (b) motivates the Company to take actions to limit harm from that risk. One main action it can take is to promote load growth and discourage conservation. For both these reasons customers receive a benefit when the Company’s sales volume risk is removed.

C. DECOUPLING DOES NOT SIGNIFICANTLY BREAK THE MATCH BETWEEN COSTS AND REVENUES BETWEEN RATECASES.

19. Public Counsel witness Brosch’s last major argument against decoupling is that rate trackers that adjust rates between ratecases, such as decoupling, are “piecemeal rate adjustments” that violate the matching principle in ratemaking. This principle requires that all revenue and cost issues should be considered at a single point in time: a ratecase. That is because these elements are constantly moving targets that can offset each other, so must be considered together when setting rates (Exhibit 506C, pages 11:1-12:16).

20. The Coalition’s witness, Mr. Weiss, rebutted this argument (Exhibit 504, pages 3:8-4:4) by noting that the fundamental asymmetry in initiating ratecases undermines Brosch’s argument. For example, if the Company cuts costs or increases revenues between ratecases, the resulting profit flows to shareholders even though it is not subject to a tracker. This “mismatch” (or over earning) continues unabated, since it is virtually impossible for any other party to drag the utility in for a ratecase. Mr. Weiss concludes that customers should not oppose all trackers, as Mr. Brosch argues, but only those that are badly designed so lead to asymmetric results (Exhibit 504, page 5:3-10). Thus decoupling, if well-designed, actually maintains the matching principle better than the current regime where the utility controls if and when it will come in for a ratecase.

IV. THE COMMISSION SHOULD CONDITION APPROVAL OF GAS DECOUPLING ON ANNUAL COMPANY PERFORMANCE IN RELATION TO AGGRESSIVE YET ACHIEVABLE CONSERVATION GOALS.

A. DECOUPLING DOES NOT PROVIDE AN INCENTIVE TO ACQUIRE CONSERVATION.

21. No Party contested the fact that decoupling only makes the Company indifferent to per customer usage, but does not provide an incentive to promote conservation.

B. THE COMPANY'S FINE RECORD REGARDING ENERGY EFFICIENCY SHOULD NOT BE USED TO DISAPPROVE DECOUPLING.

22. No Party contested the fact that PSE has a well-earned reputation under the leadership and direction of CEO Steve Reynolds for achieving efficiency at a reasonable cost, encouraging its customers to do likewise, and not impeding legislative or administrative efforts to tighten codes and standards. Therefore it is not surprising that one Party, Public Counsel, has questioned why decoupling is needed to change this Company's behavior (Exhibit 506C, pages 40:2-41:14). Public Counsel argues that if the Commission is concerned about the possible disincentive to promote conservation, it should instead design more targeted incentives that provide compensation "for only the margin dollars actually lost to utility conservation programs." (Exhibit 506C, pages 41:15-42:22).

23. Staff witness Steward rebutted this argument by noting that lost margin mechanisms: (a) bring high administrative costs; (b) leave a disincentive for the utility to pursue harder-to-measure educational efforts or to support other independent efficiency efforts; and (c) do not remove the utility's incentive to promote use in other ways. (Exhibit 561, pages 12:13-13:9). The Coalition adds

that incentive mechanisms alone cannot incent a more holistic change to a traditional utility corporate culture, since profit and success will still be caused and measured by increased sales and growth (Exhibit 504, pages 7:18-8:12).

24. The overall question—why PSE needs (or deserves) decoupling versus more narrowly defined incentives—has two main answers. First, we are not confident that the Company can maintain its enthusiasm for reducing per-customer use while facing reduced profits the more successful those efforts are (ibid). Unlike the electricity side in which the region and PSE have had long experience, the potential for gas efficiency has hardly been cracked. We therefore believe that the Company must be positioned at its highest executive level to be able to marshal the resources needed to aggressively pursue gas efficiency. Only decoupling can garner that support.

25. The second reason is that it is counter-productive in the long run to punish a company for its success in helping customers lower their bills. Just as a major purpose of decoupling appears at first to be a contradiction—separating profits from sales (Exhibit 502, page 3:19-20)—it is also not a contradiction that it is in the public interest to align the interests of regulators (and advocates) with the utilities they regulate. This wider public interest goal would be harmed by denying decoupling to a socially responsible utility that both aggressively pursues conservation in the face of lost margins (and profits) and proposes innovative mechanisms (decoupling) to solve that problem. Doing so would give PSE, and the other regional utilities that are watching this process, the terrible signal that

regulatory innovation and the pursuit of conservation in the face of lost profits is not welcomed in this state.

C. THE COMPANY'S FINE RECORD REGARDING ENERGY EFFICIENCY DOES NOT WARRANT A LACK OF AGGRESSIVE TARGETS, PENALTIES AND INCENTIVES TO ACQUIRE ENERGY EFFICIENCY.

26. Decoupling undoubtedly provides a benefit to PSE by reducing its risk of not collecting authorized margins. Some or all of that benefit will flow to customers if the Commission authorizes a reduction in the Company's cost of capital. The appropriate amount, however, is outside the expertise of the Coalition. In addition, the Company will likely recover more of its authorized margins under decoupling than it would otherwise due to the fact that the evidence shows that customer use per-customer is declining. (Exhibit 561, page 8:13-14 and Exhibit 502, pages 12:3-13:3) The Commission should not allow the Company to improve its profits due to this factor without providing customers immediate evidence that this extra cost will result in reduced bills through increased conservation spending by the Company.

27. The Coalition believes the Company's recent Least Cost Plans indicate there is considerable room for improved conservation performance (Exhibit 502, page 10:4-11). The aggressive yet achievable targets, penalties and incentives Mr. Weiss proposed (*ibid.*) are needed to give customers the confidence that the Company's efforts will continue and expand.

V. THE COALITION SUPPORTS MANY ASPECTS OF PSE'S DECOUPLING PROPOSAL, BUT IT SHOULD BE IMPROVED.

28. The Coalition supports the underlying concept represented in PSE's GNRA, but has suggested a number of modifications that would improve it considerably. These are summarized in Exhibit 502, pages 22-24. They include: a modification for new customers; a cap on adjustments if the Company cannot implement a within-month weather adjustment like NW Natural's WARM program; a thorough evaluation; and, detailed conservation commitments.

VI. THE COMMISSION SHOULD REJECT PSE'S PROPOSAL TO RAISE THE RESIDENTIAL GAS CUSTOMER CHARGE.

A. THE PROPOSAL TO RAISE THE RESIDENTIAL GAS CUSTOMER CHARGE WAS INTRODUCED IN REBUTTAL TESTIMONY, THEREBY LIMITING PARTIES' ABILITY TO INTRODUCE COUNTERING EVIDENCE.

29. PSE introduced its proposal to raise the customer charge for residential customers, even if decoupling is approved, in its rebuttal testimony (Exhibit 31, pages 5:7-10:9-11, Exhibit 186, page 5). Introducing this proposal at rebuttal unfairly and inappropriately limited the Parties' ability to introduce countervailing evidence.

30. PSE witness Hoff attempts to justify this late introduction by arguing that the proposal is in response to other parties' prefiled response testimony (Exhibit 186, page 5:2-4). He attempts to connect the new proposal to testimony of the Joint Parties, but identifies no testimony in which they or any other Party argue for such a large charge. In particular, he attempts to use the testimony of Staff witness Steward to justify this late change of direction by linking it to her rate design principles (Exhibit 186, pages 11:6-20:17). However he conveniently

neglects to mention that Ms. Steward specifically rejects such a proposal in her own testimony (Exhibit 561, pages 11:16-12:11).

B. SIGNIFICANTLY RAISING THE RESIDENTIAL GAS CUSTOMER CHARGE CONTRADICTS COST-CAUSATION PRINCIPLES AND PROVIDES CUSTOMERS A FALSE AND INADEQUATE PRICE SIGNAL.

31. PSE's witness Ronald Amen argues that a fixed customer charge substantially less than the Company's proposed \$17, "conveys improper price signals to customers because it recovers fixed costs through the volumetric components of the utility's rate structure." (Exhibit 31, page 8:14-16). Company witness David Hoff also discusses price signals, arguing that the lower the customer charge, "the worse the price signal becomes." (Exhibit 186, page 17:12-13)

32. Embedded in these arguments is a flawed definition of what is meant by a good or proper price signal. Clearly their definition assumes a rate structure designed so the volumetric portion collects only the embedded volumetric costs of the utility, while the fixed portion of the rate collects only the embedded fixed costs. While this definition is appropriate to rate spread and other discussions, it is not appropriate for a price signal, which by nature needs to reflect the marginal societal cost of any change in a customers' marginal usage. This definition is well-recognized by economists and indeed confirmed by Mr. Amen in responding to our questions at hearing:

Q. (Glaser) ... The efficient price signal for an economist would be the full, long-term marginal cost, is that correct?

A. (Amen) Yes, I suppose so. (Hearing Transcript, Volume V, page 501:23)

33. Thus the Company's \$17 customer charge actually would produce an inadequate price signal, because it reflects only the short-run commodity cost of gas. A proper price signal would include, at a minimum, the long-run marginal cost of gas and an amount estimated to cover the environmental cost of exploration, production, delivery and combustion of gas—especially greenhouse gas and land-use impacts. In addition, because one of the main reasons for this price signal is to indicate the value of efficiency investments to consumers, one can argue that it should also include adders reflecting the typically shorter payback periods and higher cost of capital of consumers (compared to the Company), and the presence of market barriers such as the lack of adequate information that inhibit consumers' rational efficiency investments. Finally, to capture the true value to society of efficiency investments and marginal use, an adder should reflect the elasticity value of reducing gas use discussed in Steward's testimony regarding a study by the American Council for an Energy Efficient Economy (Exhibit 561, pages 9:22-10:3). Together these factors favor a high marginal price signal, perhaps including inverted rates, but at the least a rate that results from a minimal customer service charge. Otherwise customers will not receive a proper price signal.

VII. THE COMMISSION SHOULD APPROVE A THREE-YEAR ELECTRIC ENERGY EFFICIENCY INCENTIVE/PENALTY PILOT THAT REWARDS OUTSTANDING PERFORMANCE

34. Designing a decoupling program for an electric utility with significant generating resources, such as PSE, would be more complicated than the mechanism PSE proposed on the gas side. That is because, unlike a purely distribution gas business, changes in customer use do not affect a generating utility's profits in a straightforward manner. When a gas customer's usage changes, the commodity cost changes predictably and is picked up by the gas cost tracker. It is thus easy to isolate the needed change in fixed margin that must be captured by a decoupling mechanism to make the utility neutral to such change. For a generating electric utility, on the other hand, a change in use may create either an additional profit or loss depending upon the difference between the embedded incremental cost of electricity and its market value. Therefore designing a decoupling mechanism that keeps the Company neutral depends on market prices and marginal costs that add complications. At this time, PSE's experience with electricity conservation allows for an approach that relies solely on an incentive/penalty program, even though "theoretically" decoupling is a better mechanism.

35. The Commission should approve a three year electric energy efficiency incentive/penalty pilot program that rewards outstanding performance and includes both a fixed dollar per MWh incentive and a shared savings incentive. PSE's modified proposal from Exhibit 379 is compared to those of WUTC staff, Public Counsel and the NW Energy Coalition in Exhibit 382, page 1. Although

all of the proposals are similar in structure, they embody important differences as noted in Ms. Steward's response testimony (Exhibit 569, page 2:13-16). These include differences in where the incentives start in relation to targets, the 2007 target, the calculation and level of incentives, and the calculation and level of penalties.

36. The Coalition is willing to modify its initial proposal as outlined in Ms. Glaser's direct testimony (Exhibit 499, pages 6:9-9:2) in one or both of the following ways: (1) Retain the Dead Band and Incentive Ranges as proposed by Ms. Glaser but substitute the Penalty Ranges outlined in PSE's modified proposal for those initially proposed by the Coalition (discussed in Exhibit 379, pages 16:6-19:6 and summarized in Exhibit 382, page 1, "Penalty Range" Section of Chart titled "PSE Modified Proposal August 2006"); **and/or** (2) calculate the sum of the fixed and variable incentives as proposed by WUTC staff (Exhibit 569, pages 4:8-5:11) at an absolute dollar level more consistent with that proposed by Ms. Glaser (*ibid.*). The first modification results in more parity between the incentive and penalty payments. The second results in a more gradual increase in the "incentive per incremental MWh conserved."

37. The design criteria (Exhibit 513) jointly supported by Public Counsel, WUTC staff and the Coalition are critical elements of any electric energy efficiency incentive pilot. All the criteria provide important detail necessary for the integrity of the pilot.

VIII. CONCLUSION: EITHER A DIRECT INCENTIVE OR A DECOUPLING MECHANISM CAN BE STRUCTURED TO ALIGN CUSTOMER AND SHAREHOLDER INTERESTS. THE COALITION RECOMMENDS THAT BOTH BE PILOTED AND THAT THE MORE COMPREHENSIVE MECHANISM, DECOUPLING, BE IMPLEMENTED WHERE THERE ARE GREATER BARRIERS TO INVESTMENTS IN ENERGY EFFICIENCY - - THE GAS MARKET.

38. The Commission should take this opportunity to align customer and shareholder interests to invest aggressively in cost-effective conservation by both piloting a natural gas decoupling mechanism and an electric efficiency direct incentive mechanism. The residential gas customer charge should be retained at its current level during the term of the decoupling pilot.

DATED: October 30, 2006

By: _____

Nancy Glaser

NW Energy Coalition