

**COMMENTS SUMMARY**  
**From June 4 and Reply Comments From June 18, 2010**  
**Conservation Incentive Inquiry**  
**Docket U-100522**

<b>Consolidated Issue list - <u>General</u></b>	<b>COMMENTS</b>
<p><i>1. Definitions.</i> What is decoupling? What is lost margin? How is it measured? What are fixed costs?</p>	<p><b>General Comments:</b></p> <p>Puget Sound Energy (PSE) finds acceptable the glossary of terms in Appendix B to <i>Aligning Utility Incentives with Investment in Energy Efficiency</i> (November 2007) by the National Action Plan for Energy Efficiency. It also provides several calculations of its lost margin over several time periods.</p> <p>Northwest Energy Efficiency Alliance (NEEA) poses three overarching concerns for the Rulemaking: (1) that the discussion of incentives focus on bill impacts rather than rate impacts; (2) that emphasis be placed on the benefits of energy efficiency to all ratepayers rather than on its costs alone; and (3) that any incentive structure that arises from this inquiry ought to include recognition for and treatment of longer term market effects savings, and not simply short-term energy savings acquisition.</p> <p>Cost Management Services, Inc. (CMS) urges the Commission to transfer conservation programs to an independent, separately accountable organization. CMS suggests the Energy Trust of Oregon as a prototype.</p> <p>Industrial Customers of Northwest Utilities (ICNU) commented generally that they support the development of cost-effective conservation resources as an essential component of Washington’s investor owned utilities least cost portfolios, but they oppose electric decoupling because it is unnecessary to ensure the utilities requirement to obtain all cost-effective conservation resources and it comes at a very high cost to customers by shifting risks, encouraging utility management mediocrity, providing inaccurate and cumbersome price signals and discouraging customer-financed conservation and energy efficiency. ICNU believes that if the Commission allows decoupling programs, they should exempt industrial customers and be tailored to address those few clearly identifiable lost margins associated with incremental utility conservation programs with an adjustment to the authorized rate of return.</p>

The Northwest Industrial Gas Users (NWIGU) recommends that if the commission adopts rules or a general policy statement, it must account for the differences between the gas and electric utilities.

Avista responds to suggestions of a third party administrator of energy efficiency programs by stating that the lost margin problem will still exist and that the existence of energy efficiency programs within the utility reduces any tendency by the utility to increase energy use.

In its reply comments, Public Counsel notes the utilities comments de-emphasis of conservation incentives and a focus instead on pure cost recovery arguments and issues. Public Counsel states that 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. Public Counsel identifies this as surprising given that decoupling has almost uniformly been advocated by utilities and some conservation supporters as a key part of improving conservation performance. In response to PSE's comments that provide some information about the status of decoupling and conservation incentives around the country, Public Counsel directs parties to the survey of the status of decoupling in the United States in the post-hearing legal briefs of Avista's 2009 general rate case.

**Decoupling:**

Avista, Cascade Natural Gas (Cascade), ICNU, NW Natural and PacifiCorp define decoupling similarly, as a ratemaking and regulatory approach designed to break the link between a utility's recovery of fixed costs and a consumer's energy consumption. Northwest Industrial Gas Users (NWIGU) provides a variation on the theme, defining decoupling as a rate mechanism that theoretically breaks the link between a utility's *profits* and the sale of commodity. PSE's definition varies by allowing that the mechanism may only weaken, rather than eliminate, that link and adding that the mechanism includes an adjustment to rates to *recover authorized revenues* independent of sales. Similar to PSE, Northwest Energy Coalition (NVEC) defines decoupling as a mechanism that makes regular adjustments in retail rates to eliminate any difference between authorized and actual recovery of a utility's allowed revenue as a result of fluctuations in retail energy

consumption on either total or on a per customer basis. NWECA adds decoupling assures recovery of a pre-defined or formulaic distribution revenue requirement, which has been approved by the regulatory agency, adjusted over time for inflation and productivity, or adjusted to reflect customer growth or another metric of growth. Public Counsel defines decoupling as a de-link of the utility company's revenues from its sales of electricity or gas noting that there is full decoupling that includes an adjustment for weather and partial decoupling that does not include such an adjustment. Northwest energy efficiency alliance (NEEA) and CMS did not provide definitions. The Energy Project describes decoupling as the idea that a mechanism can successfully remove a utility's disincentive to promote real conservation savings by restoring to them some of the revenue they lost when customers conserved.

In its reply, Public Counsel responds to NWECA's definition by noting that the two decoupling mechanisms approved in Washington is quite different and based on the overall approved revenue requirement, but instead are designed around usage per customer. Public Counsel describes NWECA's definition as a form that is essentially a revenue stabilization device that fully guarantees that the utility will recover its authorized revenue under all circumstances. Public Counsel asserts that utilities' do not propose NWECA's definition because it is based on total revenues and utilities would be making regular payments to their customers because of the pattern of growth in new sales. Public Counsel also surmises that now electric utility, save one five years ago, has proposed decoupling because average per-customer-use has been going up.

**Lost Margin:**

PSE, Cascade, and PacifiCorp define lost margin as the reduction in revenue to cover fixed costs. PSE adds that the reduction including an effect on earnings or profits in the case of investor-owned utilities. PSE also distinguishes lost margin from being only concerned with fixed cost recovery, or with the opportunity costs of lost margins that would have been added to net income or created a cash buffer in excess of that reflected in the last rate case. Perhaps similar to Cascade and PacifiCorp's definition, INCU defines lost margin as the inability to recover part or the entire margin where margin is difference between the sales price and the cost production. Avista defines lost margin more narrowly stating lost margin is the fixed costs that have been approved for recovery in rates but are not recovered due to reduced use per customer resulting from "programmatic" and "non-programmatic" demand side management (DSM). NW Natural defines lost margin as the amount that the utility would have recovered had customers consumed a forecasted amount of energy.

NWIGU defines lost margin as the decrease in profits due to legitimate conservation efforts that are the result of utility sponsored conservation programs. The Energy Project defines lost margin as the portion of the sale price of a unit of energy that is not due to the commodity cost. The Energy Project cautions however that since the price of a kilowatt or therm is determined going forward by spreading the revenue requirement across the expected sales, based on a number of assumptions/estimations such as a “normal” weather, number of customers, economic growth, etc., it is incorrect automatically to assume that a utility does not adequately recover the revenue they need because they do not collect that portion of a kilowatt or therm saved. NWEAC defines margin as the non-gas cost where gas costs include capital and O&M costs as well as the purchase costs of gas. NWEAC describes lost margin as primarily a gas utility concept that within the context of mechanisms to remove disincentives for utility investment in energy efficiency refers to the assured recovery of the lost margin. Public Counsel utilizing commission language from a commission order defines margin revenues as the revenue necessary for a utility to recover its total cost of service net of purchased gas expenses and other expenses treated as flow through items in rates. Continuing its reference to a commission order, Public Counsel states a utility’s per customer margin revenue is simply the total cost of service, as determined in the most recent general rate case, divided by the number of customers.”

**Fixed Costs:**

PSE, ICNU, NWIGU, Public Counsel and Cascade define fixed costs as expenses incurred by the utility that do not change in proportion to the volume of sales within a relevant time period. Similar to PSE’s definition, PacifiCorp’s definition of fixed cost are those costs incurred to render electric service that remains constant regardless of usage. According to PacifiCorp, fixed costs include items such as meter costs, transformer costs, distribution service, poles and conductor costs, and customer service and billing costs.

Avista also defines fixed costs as costs that do not vary with customer consumption but adds that they are fixed costs as previously approved for recovery by the Commission. NW natural defines fixed costs as the expenses the company incurs to deliver gas service, regardless of how much gas is consumed and includes as examples, pipeline maintenance, customer billing, meter reading and call center costs. NWEAC defines fixed costs to include non-production costs.

Consolidated Issue list	COMMENTS
<p>2) <i>Recovery of Conservation Program Costs.</i> Are the utilities' conservation program costs recovered from ratepayers in a timely manner?</p> <p>a. If cost recovery is untimely, please describe how and why.</p> <p>b. Are there other methods of funding conservation programs that would be more efficient and effective at acquiring conservation resources?</p>	<p><b>Part a</b></p> <p>PSE doesn't consider the recovery of electric program costs as unduly untimely. PSE states that there is still a lag between the approval of the two-year conservation program and the a rate increase in April to the cover the program costs for each calendar year the program is running and proposes the gap be removed.</p> <p>Avista agrees that costs are recovered in a timely manner stating that direct program expenses are currently expensed each year, and the combination of Tariff Rider revenues and deferred accounting provide recovery of those costs.</p> <p>PacifiCorp states that its costs associated with conservation programs have historically been recovered in a timely manner but that there are now additional costs for the planning, delivery, and reporting process to facilitate I-937 that are not collected in its system benefit charge.</p> <p>Cascade considers the updating of rate schedules every 12 months as adequate to recover administrative and programmatic delivery costs associated with Conservation Programs.</p> <p>CMS does not consider this issue a valid concern.</p> <p>NW Natural finds their recovery method to be equitable. Conservation costs are deferred for collection in the next Purchased Gas Adjustment (PGA) cycle. This process creates regulatory lag balanced by the accrual of interest.</p> <p>ICNU concludes that the utilities' current conservation tariffs and funding mechanisms are robust and adjust enough to allow for timely cost recovery.</p> <p>The Energy Project, NVEC, NWIGU and Public Counsel believe utilities have the opportunity to recover costs in a timely manner.</p> <p><b>Part (b)</b></p> <p>Avista asserts that it would be appropriate to consider capitalizing a portion of the DSM acquisition to place it on more of a "level playing field" with other resource acquisitions such as supply side resources that receive a return on equity. To the claim that Avista has not used this option, Avista states that at least in part, because since 1995 we have not been</p>

	<p>capitalizing energy efficiency costs, and there is no ongoing investment upon which to add the incentive rate of return.</p> <p>ICNU suggests that the Commission could remove the utilities from the administration of conservation programs in a way similar to Oregon's use of the Energy Trust of Oregon (ETO). ICNU states that the ETO has been successful in funding a significant amount of cost effective conservation and this structure removes the control of funding sources and management of conservation programs from the utilities.</p> <p>The Energy Project considers the crux of the problem to be the conflicted interests of the utility and so, The Energy Project recommends a rigorous study of the pros and cons of third party energy service delivery options, such as the ETO, Efficiency Vermont, California's third party non-utility administrators, and other such examples domestically and abroad.</p> <p>Public Counsel also suggests that ETO type alternatives be considered.</p>
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<b>Consolidated Issue list - <u>Impact of Conservation Resource Development on Rate of Return</u></b>	<b>COMMENTS</b>
<p>3. <i>Statement of the Issue.</i> 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?</p>	<p>PSE states that it does not believe the development of conservation resources by itself denies utilities an opportunity to earn their allowed rate of return. However, it does state that it considers the financial impact of conservation resources results in downward pressure on a utility’s opportunity to earn its allowed rate of return and that the problem is aggravated in Washington state by the use of historic test years in rate cases. PSE states attrition studies in Washington state have not had a clearly defined procedural methodology and are not the best way to determine the impact of conservation. PSE proposes that a future test year methodology, along the lines of the method used by the Federal Energy Regulatory Commission, would be a better alternative for determining the impact of conservation.</p> <p>Avista asserts that recovery of all costs (including fixed costs and a return) are currently not provided in Washington. Avista reasons that an attrition adjustment, by itself, would not be an appropriate mechanism because in the past, the UTC has linked, to some degree, an attrition adjustment to a utility experiencing financial hardship.</p> <p>PacifiCorp states that the use of historic billing determinants in general rate cases creates lost margins and affects a utility’s ability to earn its authorized rate of return. PacifiCorp estimates that conservation activities not being reflected in the loads upon which rates are set presently results in lost margins of approximately \$0.8 to \$1.2 million per year for the Company.</p> <p>Cascade posits that the acquisition of conservation resources can deny the utility the opportunity to earn its allowed rate of return. Cascade describes an attrition study as one tool to answer this question but observes that the reduction in usage is tough to analyze and attribute to any one cause.</p> <p>NEEA states that it doesn’t find any intrinsic reason that a utility would be denied the ability to achieve its rate of return simply because it develops conservation resources but notes that without an incentive structure the absolute dollar value of the ROR will be less</p>

with conservation resources when compared to a similar investment in generation. NEEA provides several examples of studies it considers insightful for helping in establishing incentives.

Considering the utility's filing of annual rate cases, CMS concluded that the commission has occasion to provide the utility an opportunity to earn its allowed rate of return.

In its response, NW Natural states, "In a non-decoupled utility, rates are set in such a way that the utility will recover its fixed costs and allowed rate of return if customers consume forecasted volumes. If customers do not consume those volumes, the utility will be unable to recover its fixed costs and earn its allowed rate of return, all else being equal. This structure creates a clear incentive for the utility to push consumption of volumes. For natural gas utilities that have been experiencing declining usage per customer each year and have stayed out of rate cases for many years at a time, the inability to earn an allowed rate of return is exacerbated. An allowance for attrition and declining use, and a rate mechanism to automatically adjust rates for those factors, could be a means of addressing this concern."

ICNU states that the development of conservation programs does not prevent utilities from earning their allowed rate of return. It states utilities have never provided quantifiable evidence to demonstrate lost margin due to conservation programs have had any significant impact on earning their allowed rate of return. ICNU points out that this risk is mitigated by annual utility rate proceedings in addition to the power cost adjustment mechanisms for PSE and Avista which protect against regulatory lag and an increase in power related costs.

The Energy Project does not agree that the development of conservation resources automatically deny the utility an opportunity to earn their allowed rate of return.

NWIGU states that it has not seen any evidence to suggest that the development of conservation resources deny any Washington utility an opportunity to earn a rate of return.

Public Counsel states that utilities have not been able to demonstrate that they are denied the opportunity to earn their allowed rate of return as a result of developing conservation programs. In its reply, Public Counsel states that PSE's argument for the use of a future



test year is far more uncertain and speculative than the use of an historical test year and exposes customers to significantly greater risk of paying unwarranted, excessive, or inaccurate charges. In its reply Public Counsel notes that Avista agrees that conservation is the least cost resource and that the point underscores Public Counsel's comments that acquisition of conservation as a resource is actually beneficial economically to utilities. Public Counsel responds to Avista's argument that recovery of all costs (including fixed costs) and a return is not currently provided in Washington, by stating that regulation seeks to emulate the effects of competition, which does not guarantee returns or cost recovery for firms in the marketplace. Public Counsel states that 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 managed. In its response, Public Counsel suggests it is reasonable to ask how serious the underlying problem is if Avista objects to attrition studies because there is a requirement to show a financial hardship caused by conservation and unrecovered fixed cost.

NWEC states that conservation programs could adversely impact an IOU's ability to earn its allowed rate of return if and to the extent sales are reduced but energy freed up for sale to the market may add revenue.

In reply NWIGU states that it observed comments suggesting that the acquisition of conservation resources "can" deny the utility the opportunity to earn its allowed rate of return but it didn't observe any evidence to support such a conclusion.

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<p>4. <i>Magnitude of the Risk.</i> 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?</p>	<p>PSE provides its calculation of lost margin attributed to its conservation programs in Exhibit B for first year conservation savings, monthly accumulation, and since 2004. PSE states that it has not formulated such an estimate of how much lost margin can be attributed to other types (non-company sponsored conservation).</p> <p>Avista provides that for 2009, total lost margin for programmatic DSM and the Northwest Energy Efficiency Alliance (NEEA) was \$1,605,236. Avista asserts that it would be even higher if the estimate included non-programmatic DSM.</p> <p>Cascade concludes that measuring the lost margins due solely to a utility’s conservation program is difficult and can only be established on a generic basis due to assumption about the customer’s circumstances (for example the type/size of the customer dwelling).</p> <p>NEEA asserts that combination of the items listed in Question 6 and their interrelationships may actually be so intertwined and complexly related that their segregation leads to false indications. NEEA provides for example that parts a, b, and c of Question 6 always act together and in many cases lead to e. NEEA also thinks part d, f and g are part of the same customer initiated response to markets and new technologies. NEEA concludes that trying to separate out attribution of each of the causes of load loss (or reduction below what it might have been) is logically intractable and is not necessary to establish a strategic system of incentives for utilities.</p> <p>CMS responds to this issue by questioning the extent to which the commission should protect energy companies against the business risks of conservation, in the first place.</p> <p>NW Natural states that in its 2009 IRP it estimated that residential use per customer will drop by 3.9% over 5 years, commercial by 7.9% and industrial firm sales by 0.4%. NW Natural finds it difficult, if not impossible to separate the decline in consumption from utility-sponsored conservation and other factors. NW Natural comments that the recovery of a portion of the declining use will not break the link between consumption and fixed cost recovery and a utility will maintain their incentive to “encourage consumption to ensure its ability to recover fixed costs and earn its allowed rate of return.” NW Natural</p>

refers to Christensen Associates Energy Consulting recommendation that NW Natural recover 100% of the difference between baseline usage and actual usage.

ICNU feels that there is only a small amount of potential lost margin associated with utility conservation programs particularly since power costs are increasing and the electric utilities are not in a power surplus mode. ICNU does not agree that an electric decoupling program is appropriate until it can be demonstrated that significant lost margin is a result of incremental utility conservation programs. In addition, they state “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. ICNU argues that lost margins associated with conservation programs the utility does not control should be excluded, including independent customer conservation efforts, substitution of fuels, conservation because of building codes and other standards, NEEA conservation savings that are not counted in the utility’s programmatic or information efforts, and simple demand elasticity from heating fewer rooms or lowering the thermostat.

ICNU feels that there is a baseline amount of conservation that even utilities that allegedly have a disincentive will invest in. ICNU encourages the Commission to require utilities to provide “detailed, empirical evidence” of the amount of lost margin and its causes.

The Energy Project is not aware of analysis that provides the comparative risk evaluation the second question requests, but thinks it is important to make the comparison.

NWIGU considers it impossible to determine with true accuracy the actual causes of alleged lost margin from other types of conservation listed in Question 6. In its reply comments, NWIGU states that to properly study the question of risk parties must be given the opportunity for review and comment in a proceeding with the opportunity for discovery, cross-examination and witness presentation.

Public Counsel provides support through recent cases that the ratio of lost margin resulting from utility sponsored DSM programs is very small compared to the total amount deferred and subject for recovery from ratepayers under the two decoupling proposals. Public Counsel also states that lost margins primarily consist of usage reductions from causes other than company-sponsored conservation programs. In its reply Public Counsel raises

questions about the data PSE provides on the size of its lost margins. Public Counsel states that the figures appear to be cumulative, reflecting reduced usage since October 2004 and don't take into account intervening rate cases or offsets such as increasing load. On the point of offsets, Public Counsel, referencing the Blue Ridge report on the first two years of PSE's electric conservation incentive mechanism, states that in each of the past five years, actual sales to consumers have exceeded the company's load forecast. Public Counsel also asserts that Avista's numbers on 2009 lost margin do not add up and Avista makes no mention of the data on lost margins developed in connection with its own decoupling mechanism.

NWEC did not respond directly to this question.

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<p><b>5. Direct Conservation Incentives and Rate of Return.</b> 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?</p>	<p>PSE states that the commission should distinguish between incentives to go beyond the minimum conservation goal set by the commission and fixed cost recovery achieved through mechanisms such as decoupling. PSE states incentives should be designed to go a step beyond cost recovery, rewarding innovation and performance.</p> <p>Avista states that an “incentive” is just that and therefore is not a substitute for decoupling, fixed cost recovery, or capitalizing (of conservation funding). Avista also asserts that it would not be seeking incentive payments for acquiring conservation resources but only for a clearly defined achievement beyond its stated conservation goals. To the claim that decoupling shifts risk away from the utility, Avista states that because of the increased focus on energy efficiency it is necessary to address lost margin recovery to preserve the prior balance of risk between shareholders and customers.</p> <p>Cascade considers incentive programs ineffective substitutes for decoupling, in part, because, incentive programs often include penalties for not reaching conservation targets. Cascade describes two problems with incentive targets: 1) ultimately customers decide whether to participate in conservation programs and 2) utility promotion of conservation may lead to customer conservation that does not utilize utility programs and therefore is not counted toward the achievement of the target.</p> <p>NEEA argues that incentives alone are not an assurance that the utility will earn a sufficient rate of return and considers incentives as a tool to promote other goals. Citing to a paper by Cappers et al., NEEA states that decoupling and incentives can each be done alone or in combination, but that under many circumstances, the combination of both may produce the highest benefit to all stakeholders.</p> <p>CMS responds to this issue by rejecting a utility’s role as a conservation provider and suggests that conservation programs be transferred to a third party provider. CMS reasons that provision of incentives to the utility to undercut their own business of selling energy only makes the contradiction of motivations more bureaucratic.</p> <p>NW Natural states that incentives can be used for various purposes and can be similar to</p>

decoupling by provided a financial reward for implementing demand side management. If incentives are used instead of decoupling, NW Natural reasons that the magnitude recovery in an incentive mechanism may not equal decoupling causing a utility to under earn.

ICNU states that the sole purpose of conservation incentives should be to provide appropriate rewards and penalties to encourage the utilities to obtain a specific amount of cost effective conservation. ICNU also states that conservation incentives should not be used to ensure the utilities earn their authorized rate of return. ICNU believes conservation incentives may be a substitute for decoupling although there is no reason to adopt any form of decoupling if the disincentive to invest in conservation does not exist or is removed by other means.

NWEC believes the purpose of a performance-based incentive mechanism is to encourage significant levels of cost-effective conservation. NWEC recommends incentives be put into place when energy efficiency programs are ramping up to high levels or to motivate a utility to continue performing at a high level. NWEC states that incentives do not address the sufficiency of the rate of return. NWEC states that, generally, an incentive program is not an effective substitute for decoupling and that multiple approaches may produce equally beneficial results.

The Energy Project states it does not see paying an incentive as the same as removing a disincentive, or penalizing failure. The Energy Project states that it considers the effectiveness of incentives versus decoupling to reside in the difference between the sizes of the cash flows from ratepayers to the company.

NWIGU considers it a requirement of law that utilities pursue conservation with, or without, incentives.

Public Counsel states the value of incentives (rather than the removal of disincentives) can be the provision of positive motivation towards the acquisition of conservation. Public Counsel supports targeted incentive payments instead of decoupling since they offer a direct a precise way to obtain the behavior decoupling seeks. Public Counsel also states that the need for incentives should be viewed differently in light of I-937 requirements which they further explain in response to question 14. Public Counsel states that the most common rationale offered for incentive payments is to encourage conservation, rather than to address

	<p>rate of return issues and they see little if any evidence that rate of return is negatively impacted by conservation. Public Counsel concludes that almost annual filings of general rate cases by the utilities allow the utilities to request relief from any failure to earn a reasonable rate of return. Public counsel responds to NWECC cite to 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), by citing the preface of the report 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.</p>
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<b><u>Consolidated Issue list - Details of a Conservation Incentive Mechanism</u></b>	<b>COMMENTS</b>
<p><b>6. Categories of Lost Margin Due to Conservation Eligible for Recovery.</b> 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:</p> <p>a. Margin decline from company-sponsored conservation programs that provide a rebate or that provide direct assistance with conservation-measure deployment (such as site visit evaluation).</p> <p>b. Information provided by the utility to the customer, such as educational programs, bill inserts, or information on the utility's website.</p> <p>c. 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</p>	<p>PSE states all the factors listed in Issue 6 should theoretically be included in a mechanism to facilitate full recovery of all lost margin but acknowledges that some of these factors are difficult to individually measure and attribute savings too. PSE states that decoupling includes all of these categories without having to calculate any particular one. PSE states that, when possible, it relies on the Regional Technical Forum for calculating conservation savings. PSE notes that items a-g do not include improvements to distribution system efficiency, such as conservation voltage reduction (CVR).</p> <p>PacifiCorp states that at this time it is not advocating for incentives but does believe that the removal of disincentives is appropriate. It proposes two ways for dealing with this: 1) implementing a higher fixed charge and 2) the use of forecast billing determinants for setting rates.</p> <p>NW Natural states that utilities should receive recovery for all lost margin as measured by the difference between actual usage and the forecasted baseline used to establish rates.</p> <p>NWIGU considers its margins in item a recoverable if proper EM&amp;V is applied as well as educational efforts by the utilities if highly scrutinized. NWIGU doesn't agree that margin decline from independent customer conservation, codes and standards, elasticity and substitution should be recovered.</p> <p>CMS advised that the commission wait for the results of existing decoupling pilots before engaging the list but, regardless, the issue seems to pose a set of imponderable questions.</p> <p>The Energy Project does not agree any of these items should be categorically subject to recovery because of a calculation that only includes these items affects on a utility's revenue concludes that the utility is not making their allowed rate of return.</p> <p>If the Commission feels that an incentive mechanism is appropriate, Public Counsel recommends that the incentive should be limited the proportion of lost margins attributed to</p>



<p>conservation savings that occur for the purposes of a cost recovery mechanism?</p> <p>d. Independent customer conservation efforts (no rebate or direct utility assistance documented).</p> <p>e. Conservation due to codes and standards.</p> <p>f. Elasticity (i.e., heating fewer rooms, lowering thermostat, et cetera).</p> <p>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.</p> <p>h. Other (describe).</p>	<p>utility-sponsored DSM programs and be dependent on meeting clearly defined DSM performance targets subject to meaningful EM&amp;V as well as an earnings test. In response to claims that individual causes of decline in use cannot be identified, Public Counsel that rigorous savings estimates are important in order to ensure that ratepayers' investment in conservation programs is funding prudent and cost-effective energy efficiency programs.</p> <p>As described in NEEA's response to question 4, NEEA considers trying to separate out attribution of each of the causes of load loss (or reduction below what load might have been) as both analytically intractable and unnecessary to provide adequate incentives to IOUs in Washington.</p> <p>NWEC did not directly address the issue, but it agreed that measurement was important.</p> <p><b>Part a</b></p> <p>Avista asserts that programmatic participation is highly measurable and represents the most documentable representation of the direct impact of utility conservation programs. Avista concludes recovery of lost margins for this category is appropriate.</p> <p>The Energy project concludes that perhaps Part a may be the easiest to quantify with a third party evaluator.</p> <p>If the Commission approved an incentive, Public Counsel states that only the lost margins due to company-sponsored programs should be included and only if the savings are reliable and been independently verified. Public Counsel also conditions recovery in this scenario on other programmatic requirements being met first such as cost-effectiveness standards and earnings tests. Public Counsel provides more detail to EM&amp;V in its response to 12-24.</p> <p><b>Part b</b></p> <p>Avista conditions that to the extent utility educational efforts yield a measurable change in customer's energy use, independent of all other influences, lost margin recovery should be allowed.</p> <p>Public Counsel states that utilities should not be allowed to recover lost margins associated with educational programs or information provided by utilities for two reasons: 1) measure</p>
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specific programs count customers who participate and by counting educational programs there would be inappropriate double counting, 2) the outcome from educational and informational programs has not yet been measured or verified so it is premature to claim savings from these programs.

**Part c**

Avista reasons that the allocation of NEEA savings should be incorporated into lost margin calculations and any incentive calculations based on Avista's assertion that the NEEA savings being can be both "net" of natural adoption and incorporate an adjustment to the regional claim to avoid "double-counting" the energy savings.

Public Counsel states that they have supported NEEA and market transformation efforts as far as expense recovery although Public Counsel considers it difficult to determine actual savings related to these programs.

The Energy project concludes that perhaps item c may be the easiest to quantify with a third party evaluator.

**Part d**

Avista cautions that due to the difficulty of demonstrable the influence by the utility on efficiency measures or behaviors adopted by the customer without the documented participation in a utility program, it would be difficult to develop a metric of success that is sufficiently precise to warrant inclusion for cost recovery.

The Energy Project does not agree that any recovery for item d should be allowed and that doing so may decrease the customer incentive to conserve or for item f because it is a risk we pay utility's to take and it often constitutes deprivation for the customer.

Public Counsel does not believe that independent customer conservation efforts should be subject to recovery by the utility since it would allow a guaranteed amount of recovery regardless of expense, overall sales volumes or investment in conservation.

**Part e**

PSE states energy savings due to codes and standards (item e) may be quantified by relying on statewide or utility studies of code/standard compliance and a consistent method of distributing the savings between utilities and eliminating any double-counting of savings that may be claimed in other programs.

Avista concludes energy savings derived from higher codes and standards are reasonably measurable and therefore lost margin recovery would be appropriate.

Public Counsel believes conservation due to codes and standards should not be considered for utility recovery

**Part f**

Avista conditions that, to the extent DSM is related to education, communications and energy efficiency efforts promoted by the utility, lost margin recovery would be appropriate.

Public Counsel does not agree with the recovery of the effects of elasticity.

**Part g**

For item g, PSE believes that energy savings can be calculated from “substitution” on a “net energy” basis, where the Btu equivalent of the energy load being reduced is netted against the Btu equivalent of the substitute energy source.

Public Counsel believes fuel switching should only be accounted for to the extent it is directly sponsored by the utility and any increased usage due to the new fuel source should be accounted for and offset in the savings associated with the old fuel source.

Consolidated Issue list	COMMENTS
<p><b>7. Impact of Conservation Incentive Mechanism on Utility Incentives to Encourage Consumption.</b> 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?</p>	<p>PSE observes that effect of an incentive mechanism depends on the type of mechanism. PSE does not promote the use of more energy by its customers.</p> <p>Avista states that it does not encourage customers to use more electricity and a fixed cost recovery adjustment would not change this practice.</p> <p>Cascade believes that any decline in customer usage should be subject to recovery by the utility because under current rate structure, any reduction in usage reduces the utility’s ability to cover its expenses.</p> <p>CMS reiterates its recommendation that the commission transfer conservation programs to an independent third party, short of that, the commission has authority to prohibit a utility from promoting more energy use by its customers.</p> <p>NW Natural responds, yes, without decoupling they feel that a utility would have a tendency to try to increase volumes sold.</p> <p>The Energy Project states that lost margin recovery may reduce a utilities resistance to sponsoring conservation, but that does not necessarily remove the incentive to promote more energy use.</p> <p>NWEC agrees that if a utility recovered lost margin as calculated by installed conservation measures, and usage increased, the utility would collect the extra revenues as well. NWEC states that implementing decoupling would resolve this dilemma. NWEC says some utilities are promoting the use of more energy. In the region, gas-backed heat pumps are being promoted by some electric utilities to the apparent consternation of some gas utilities, because these exacerbate gas system peaking costs, without contributing equitably to cost recovery. NWEC reasons that heat pump incentives may serve as load-retention measures, enticing customers to not install gas space heat. As a result, NWEC concludes space heating loads as well as water heat, clothes dryers and cooking ranges remain as electric loads. NWEC believes electric vehicles (which will increase system load) are being promoted, but not necessarily by utilities.</p>

As long as fixed costs are collected on a volumetric bases, NWIGU concludes that utilities will have an incentive to promote gas use.

Public Counsel believes that an earnings test could help prevent a utility from developing contradictory policies that serve to counteract the benefits from conservation. They do not see any utilities directly promoting the use of more energy.

For NEEA's comment see issue 9.

Consolidated Issue list	COMMENTS
<p>8. <i>Offsets.</i> To what extent should any recovery of lost margin be offset by revenues associated with new load (sometimes referred to as “found margin”), including:</p> <ul style="list-style-type: none"> <li>a. New customers,</li> <li>b. Additional load for existing customers,</li> <li>c. Other?</li> </ul>	<p>PSE states that if a decoupling mechanism is put into place, there is no basis for offsetting lost margin with revenues from the load of new customers or increases in the loads of existing customers. PSE asserts that new customers actually cost more to serve than existing customers. PSE also asserts that in the case of new “plug load” that might serve to increase a utility’s use per customer, this higher use per customer is necessary to overcome the current long-standing practice of basing rates to recover future costs on costs experienced by a utility more than 2 years earlier (on average, 26 months earlier).</p> <p>Avista conditions that to the extent that the incremental costs to serve new customers are lower than the embedded fixed costs, then the margin from sales to new customers could be used to offset other lost margin.</p> <p>Cascade does not agree that revenues associated with new load should be considered as an offset to the lost margin associated with conservation since the fixed costs will increase with addition of new customers.</p> <p>CMS notes that conservation efforts frees up gas transport capacity that may be use for new customers.</p> <p>NWEC believes that, in general, “found margins” should be considered to offset lost margins. NWEC notes that new customers come with incremental costs as well as new revenues. NWEC recommends that cost assumptions embedded in the utility’s existing line extension policies also should be considered. NWEC notes that reduced electricity sales can avoid both investment in power supply resources as well as operating costs, purchased power and fuel. Finally, NWEC states that increased surplus sales of energy saved by customers can create new revenues.</p> <p>NW Natural concludes that if new customers were used as an offset, but the costs of adding the new customers were ignored, the adjustment would be one sided. NW Natural argues that a decoupling mechanism can factor in the requirement for incremental revenue by resetting the baseline level of usage for the actual numbers of customers served. NW Natural asserts that determining added load for existing customers is almost impossible and decoupling would factor in any incremental load.</p>

ICNU feels that any lost margins should be offset by found margins associated with new load from new customers and additional load from existing customers. ICNU reasons that this would follow the matching principle of rate making.

The Energy Project agrees that “Found” margins should offset claimed lost margins.

NWIGU agrees that increased sales should offset lost margins if a mechanism to address lost margin is adopted. In its reply to PSE’s comments, NWIGU adamantly disagrees with the comments of Puget Sound Energy and others suggesting that there is no basis for offsetting lost margin with found margin. NWIGU states that a lost margin recovery without found margin amounts to single issue rate making.

In reply to PSE’s claim that increased loads from new or existing customers can no longer offset each other, Public Counsel claims PSE’s load has been rising since 2005 except for 2009 which Public Counsel assigns to the economic down turn.

For NEEA comments see issue 9.

**Part b**

Avista states that If the savings from DSM are offset to some degree by increased use per customer, the increased use could be used to offset the lost margin from DSM savings.

Public Counsel believes that potential spot or wholesale market sales revenue resulting from customer conservation should be considered as part of the offset.

Consolidated Issue list	COMMENTS
<p><b>9. Application to Industrial Customers.</b> 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.</p>	<p>PSE reasons that because large customers directly contribute to the problem of lost margin, they should be part of any decoupling mechanism that corrects the problem. PSE argues this holds true even if there is an incentive mechanism put in place to encourage a utility to go beyond the target set by the Commission because the large customers would receive both a direct and indirect benefit from those additional conservation savings. Therefore, large customers should also have a part in contributing to the funding of such incentives.</p> <p>Avista reasons that for programmatic DSM lost margin, if the industrial customer class pays into in the Company’s Energy Efficiency Tariff Rider, then they should be subject to lost margin recovery. However, since their sales fluctuation due to economic conditions industrial customers should not be included in a decoupling mechanism.</p> <p>Cascade reasons that the large variation in usage between large volume customers in the industrial customer class is incompatible with decoupling.</p> <p>NEEA finds no reason to exclude some class of customer from sharing in the costs and benefits of an aggressive and comprehensive conservation program since all customers benefit from the lower cost of power that comes from a cost-effective conservation program.</p> <p>CMS believes that large gas customers should not be included in utility sponsored conservation programs because they have all the incentive they need to develop cost-effective conservation and efficiency measures.</p> <p>NW Natural is open to different approaches for recovering lost margin from industrial customers. The parties agreed to a settlement in Oregon that excludes industrial customers from their decoupling mechanism. They also point out that lost margin from industrial energy efficiency plans can be significant and their collection warrant consideration whether through conservation incentive or a DSM lost margin mechanism.</p> <p>NWEC believes that all ratepayers should contribute to such a mechanism because all customers benefit from increased conservation.</p>



ICNU believes that decoupling programs should exclude industrial customers because these customers are quite large and they typically aggressively pursue both their own and their utilities' cost-effective conservation and energy efficiency programs. ICNU concludes that decoupling can discourage industrial users from reducing their usage since they would not experience the full value of the reduction.

ICNU states the negative impact to industrial customers of a utility lost margin recovery mechanism as follows:

- Discourages and penalizes the engagement in conservation programs. The limited number of customers in the class and a significant change in load can dramatically impact the entire class.
- Imposes an after the fact charge for the lost load of different customers.
- Smaller groups of customers are required to pay for the lost revenue of an entire class.
- Provides inappropriate and incorrect price signals.
- Industrial customers often invest in their own conservation programs and decoupling can be a powerful disincentive if the reward is higher future rates.

The Energy Project sees no justification for excluding any class of customers from the recovery costs.

Public Counsel believes all customer classes that are eligible for and participating in utility-sponsored programs should be considered in an incentive program if such a program is considered necessary.

NWIGU lists several reasons it uses to conclude the application of lost margin recovery is inappropriate:

- The shift of risk from the utility to the industrial customer.
- For industrial customers, reductions in sales from conservation cannot be separated from other causes.
- A utility has an opportunity to earn a rate of return that is based on the possibility that customers may choose to reduce consumption.

- The lack of rational for applying lost margin recovery to transport customers.

In its reply, NWIGU joins the comments of ICNU and others that describe the negative consequences of imposing these types of programs on industrial customers. NWIGU responds to NEEA's assertion of a benefit to all customers from conservation programs by asserting that there is no benefit or cost correlation in the natural gas market between a utility's natural gas transportation customers and the utility's conservation programs or conservation incentives or lost revenue related to those utility programs.

Consolidated Issue list	COMMENTS
<p><b>10. Other Characteristics of an Incentive Mechanism.</b> What characteristics should an incentive mechanism include?</p> <p>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?</p> <p>b. For electric utilities, should the incentive targets be different and greater than the Energy Independence Act (EIA or I-937) targets?</p> <p>c. Should there be penalties for failing to achieve the incentive mechanism’s target or rewards for achieving only a percentage of the target?</p> <p>d. Should there be an earnings test to determine if the utility is over earning?</p> <p>e. Should the incentive include all customer classes in the target and in the collection of the incentive payments?</p>	<p>If an incentive mechanism was determined necessary, Public Counsel recommends the following characteristics should be included: 1) Clearly defined DSM performance targets, 2) independent measurement, verification and reporting of achieved results, 3) emphasis on cost-effective DSM program, and 4) administrative simplicity.</p> <p>NWEC states incentive mechanisms should and supplies characteristics in its attachment A:</p> <ul style="list-style-type: none"> <li>• Focus on savings (e.g., kWh, kW, carbon) not just “net benefits;”</li> <li>• Consider, among other metrics, market transformation indicators, maximizing cost effectiveness and net benefits, minimizing costs, and equity within and between customer classes; and</li> <li>• Should be observable, measurable, verifiable, clearly aligned with policy objectives, and not create perverse incentives.</li> </ul> <p><b>Part a.</b></p> <p>PSE believes its recently expired Electric Conservation Incentive Mechanism could serve as an example of a reasonable incentive mechanism but is less effective without first addressing a utility’s unrecovered fixed costs due to conservation. Once that issue is addressed, PSE believes many reasonable approaches to an incentive mechanism could be constructed to provide an incentive for utility’s to accelerate the pace of their conservation investment.</p> <p>Avista asserts an incentive mechanism—separate and distinct from fixed cost recovery and return—should be based on achieving energy efficiency results <u>in excess</u> of the utility’s stated targets. Avista suggests several different mechanism:</p> <ol style="list-style-type: none"> <li>1) an additional rate of return (say, 2% or 200 basis points) as is provided by RCW 80.28.260,</li> <li>2) a shared savings plan could be considered in which a portion of the net benefits (for example, 10% of a generally accepted metric such as the Total Resource Cost test) could be provided to shareholders,</li> <li>3) a defined bonus which could be provided based on achievement of stated goals, or</li> </ol>

<p>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.</p>	<p>4) symmetry with RCW 19.285 (or I-937) in which the \$50/MWh penalty for not achieving targets would be balanced by a \$50/MWh reward for exceeding targets.</p> <p>NEEA considers the transparency of an absolute dollar incentive as a good attribute but doesn't recommend that a mechanism be based solely on "net" savings attributable only to utility programs because there are now many actors in the energy conservation field.</p> <p>NW Natural states that a utility should be allowed to recover an absolute dollar amount as a result of its actions.</p> <p>NWEC states recovery should be tied to savings. NWEC does not address how it should be calculated. NWEC states that the utility should have an incentive to encourage all conservation, not just programmatic.</p> <p>Public Counsel believes recovery should be proportional to utility-sponsored conservation, not all conservation that occurs over a given period and that the rewards should be set for meeting or exceeding a specific targeted amount of achieved conservation. Public Counsel believes that an incentive mechanism could be designed to simply recover an absolute dollar amount for an incentive not tied to lost margins but designed to reward achievement against conservation targets. Public Counsel states any incentive mechanism should be designed on an individual utility basis to specifically calibrate it to the utility's programs and associated lost margins.</p> <p>The Energy Project recommends that allowed recovery should be performance-based and proportional to the conservation that occurs as a result of the utility's actions.</p> <p>NWIGU recommends regardless of the mechanism type, inclusion of four principles that it says come from a UTC order issued in 1991;</p> <ol style="list-style-type: none"> <li>1) it must be measurable,</li> <li>2) it must be reasonably simple to administer,</li> <li>3) it must be easily explained to utility customers and,</li> <li>4) it must be an improvement, on balance, over the current method of regulation at the UTC.</li> </ol> <p>To these principles, NWIGU adds that the mechanism must balance the interests of the ratepayer with shareholders. Specifically, recommends that the mechanism include new</p>
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customer growth, or if not, some reduction on the utilities rate of return and a sharing mechanism as well as a provision that retains an incentive for the LDC to operate efficiently. NWIGU recommends the decoupling design used in Oregon for three of the four utilities (see NWIGU reply comments June 18).

**Part b**

PSE believes that it is reasonable to have the target that the commission approves as part of WAC 480-109-010(4)(c) be the basis for an incentive mechanism target. Avista states that incentives should be in excess of a stated target, e.g., I-937 targets.

NEEA considers targets most useful in accelerating conservation acquisition beyond the two-year minimum accomplishments required by I-937, and for focusing utilities on longer term savings, lost opportunities, and other strategic objectives.

Because the EIA may include conservation sources not tied to utility sponsored conservation programs, Public Counsel concludes targets tied to an incentive mechanism for electric utilities may be different.

NWEC states the incentive targets for electric utilities should be different and greater than I-937 targets.

The Energy Project recommends that the higher of either the utility's current IRP or their I-937 be the lowest point around which incentives or penalties are based.

**Part c**

PSE believes that it is reasonable to have balanced mechanisms that have both rewards and penalties. PSE reasons that since penalties are already in place as part of WAC 480-109-050(1) additional penalties are unnecessary in an electric incentive mechanism and PSE already has a penalty-only mechanism in place for PSE's natural gas conservation programs. Avista notes that penalties already exist in RCW 19.285 (or I-937).

NEEA considers the penalties under I-937 to be sufficient to create risk for non-performance and recommends a graduated reward mechanism rather than a yes/no reward system that puts all of the emphasis on a point estimate of accomplishment will stress the process and relies too heavily on the tools of EM&V.

NW Natural cautions that penalties may have unintentional consequences and does not favor them. NW Natural posits that utilities will manage the risk of a penalty in determining how high they set conservation targets.

NWEC believes electric IOUs should be rewarded for exceeding targets, not for achieving only some percentage of a target and notes that penalties are already in place. NWEC believes gas utilities should have a deadband for penalties and rewards.

Public Counsel's response agrees and recommends that if an incentive mechanism is adopted it should be designed so that penalties are accrued if a utility does not meet its targets and no incentive should be received if the target is not achieved.

The Energy Project considers penalties to be appropriate and does not support an incentive mechanism without a corresponding penalty.

**Part d**

PSE states the following:

“The Utilities are provided an opportunity to earn a reasonable rate of return. A utility's allowed rate of return is neither a ceiling nor a floor for utility earnings, it is an expected value based on the expectation of prudent utility management and normal operating conditions. Absent a conservation incentive mechanism, if the utility is managed efficiently, it may be rewarded with higher returns. Conversely, if it is mismanaged, it may suffer the resulting lower returns. This incentive to operate as efficiently as possible should be preserved under any conservation incentive mechanism. Tying an incentive mechanism to some sort of hard cap on earnings would be counterproductive in this regard, particularly if the utility was otherwise doing well and being operated efficiently. Therefore, if an earnings test were required, it should be fashioned in such a way that it preserves a utility's incentive to operate as efficiently as possible.”

Avista states that the incentive should be independent of other cost-recovery.

NWIGU recommends the sharing mechanism used in Oregon and provides details refers the reader to The History of Decoupling Mechanisms in Oregon on Behalf of NW Natural submitted in this docket.

NW Natural presents that earnings tests- depending on how they are conceived- could provide a reasonable check and balance.

Public Counsel agrees and cautions there should be an earnings test to ensure that the mechanism is not producing windfall revenues in comparison to margins lost from conservation programs.

The Energy Project believes there should be an earnings test.

**Part e**

PSE's believes that positive incentives for conservation program performance should include all customer classes for which programs are offered and energy savings are achieved. Avista reasons that to the extent that the customer classes fund programmatic DSM, the incentive should include all customer classes in the target and in the collection of the incentive payments.

NEEA recommends that since all customers benefit from conservation, they should all contribute to paying for the incentive.

NWIGU does not agree that industrial or transport customers should be included. NWIGU states that pro forma adjustments to account for lower loads can lead to excessive earns.

NWEC says the incentive should include all customer classes in the target and in the collection of the incentive payments.

Public Counsel believes an incentive program should include all rate schedules and customer classes to recognize all rate schedules participate and benefit from utility conservation programs.

NW Natural believes all customers eligible to receive conservation services should be subject to providing for the conservation incentive.

The Energy Project believes all customer classes should be included.

**Part f**

PSE states that it would consider a pro forma adjustment such as a more forward-looking adjustment of delivery volumes for declining average use to be complementary to any incentive mechanism in the sense that it would help utilities deal with the issue of recovery of fixed costs (lost margins). PSE asserts that a pro forma adjustment is, by itself, not an incentive mechanism and does not take care of the entire amount of unrecovered fixed costs due to conservation. Therefore, PSE concludes, in addition to such a pro forma adjustment, there would need to be a decoupling mechanism.

Avista agrees that there should be pro forma adjustment in addition to rate making policies and suggests as an example an adjustment to reduce test-period loads to reflect the planned reduction in loads related to energy efficiency as a direct way to address lost margin recovery.

Cascade does not believe an incentive mechanism would properly address reduced usage. Cascade states that an earnings test may be appropriate but that some sharing above the cap is necessary. Cascade characterizes limitations on the recovery of lost margin by application of an earnings test as producing a disincentive for the utility to reduce its costs and become more efficient.

NEEA recommends that an incentive mechanism should be designed to accomplish all of the objectives. If, for example, long term market effects or market transformation savings are not identified as a goal, the utility will not emphasize that goal. NEEA recommends that the mechanism be transparent, with risks to ratepayers limited. (See also NEEA responses to Item 24).

CMS disagrees fundamentally with the concept of fashioning financial incentives to promote conservation by regulated energy companies.



	<p>Public Counsel comments that additional rate making policies will increase the complexity and administrative burden of an incentive mechanism.</p> <p>NW Natural states that any regulatory mechanism adopted needs to consider that gas utilities are experiencing diminishing usage per customer.</p>
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<b>Consolidated Issue list – Impact on Rates</b>	<b>COMMENTS</b>
<p><i>11. Impact on Various Classes of Customers.</i> 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?</p>	<p>PSE states that the costs of an incentive mechanism should be spread in the same way as each utility's energy efficiency program costs are allocated. PSE describes the conservation funding for PSE's electric retail wheeling customers that comes from customer's contributions to Schedule 120, as effectively ring-fenced for their exclusive use through PSE's Schedule 258.</p> <p>Avista suggests two approaches. The first would be to spread the costs of the incentive mechanism proportionately to those rate schedules causing the savings. The second would be to spread the costs by adding those costs to the DSM programmatic costs, and seek recovery using the same methodologies used for the existing energy efficiency tariff riders. Avista states that natural gas transportation customers do not contribute to the Energy Efficiency Tariff Rider and as such, they should not be subject to an incentive mechanism as they are not subject to the surcharge, and therefore are appropriately protected.</p> <p>NEEA recommends not focusing on costs but rather on the benefits of the conservation load reductions– on bill impacts rather than on rates.</p> <p>NW Natural believes that the incentive mechanism should be collected from all customers applicable for conservation programs, principles that would eliminate transportation customers. NW Natural also believes costs should be allocated proportional to the gas savings experienced per rate class.</p> <p>The Energy Project contends that is essential that the design of an incentive mechanism consider the impact on low-income customers. In The Energy Projects view the basic situation is that low-income customers pay to support the utility conservation programs just as any other customer does, but are less likely to benefit from the program offerings. The Energy Project lists three major factors that contribute to the lower accessibility for low-income households:</p> <ul style="list-style-type: none"> <li>• Programs directed to the non low-income residential customer depend on a substantial contribution from those customers.</li> </ul>

- The mix of program offerings has significant impact on whether low-income customers can access energy efficiency. For example, programs such as, appliance rebate programs will seldom have much impact for low-income customers as a whole because approximately 65% of low-income customers are renters.
- Finally, the comparatively higher cost to achieve significant savings ultimately means that only a very small percent of low-income households get to participate in the programs that are targeted to them. For example, shell measures that can accomplish a significant reduction in energy use cost considerable more and may be out of reach of low-income residential customers.

The Energy Project summarizes their comments on this issue as:

- Yes, the design of an incentive mechanism should consider its impact on low-income customers.
- Yes, a lost margin recovery mechanism is likely to push more of the cost on to low income customers, partly because:
- Few low-income customers are able to benefit from utility energy efficiency program because of the high cost of the program that can significantly impact a household bill or the inaccessible nature of the non low-income measure offerings.
- No, the relationship between bill impacts and access to programs for low-income is not equitable.

PacifiCorp responds to the Energy Project's claim that low-income customers use less energy than the average customer by stating that customers on the Company's residential low-income bill assistance program, Schedule 17, have, on average, higher usage than those customers receiving service on the Company's standard residential schedule, Schedule 16.

NWIGU recommends that the commission follow cost causation principles for spreading any mechanisms costs. NWIGU finds no basis under any conditions to justified include transportation customers in a mechanism.

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

	<p>Public Counsel states that the costs associated with the mechanism should be borne by all retail customers since all retail customers' benefit from utility-sponsored conservation programs.</p> <p>For CMS's response see its reply to issue 9 and 10.</p>
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Consolidated Issue list	COMMENTS
<p><b>12. Impact on Low Income Households.</b> 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?</p>	<p>PSE asserts that there are no current facts that show that full recovery of fixed costs would cause any specific group of PSE customers to bear any extra undue burden. PSE also asserts that low-income households in the PSE service area consume the same amount of energy as an average household but adds that the only identifiable group of low-income customers is the one that have received bill assistance from the utility.</p> <p>Avista states that the design of any mechanism or program should consider the impact on all affected customer groups, including low-income and asserts that all of the Company’s existing conservation programs for residential customers are available for limited income customers.</p> <p>Cascade agrees that the design of any rate recovery mechanisms should consider the benefits and the impacts on both ratepayers and the utility. Cascade states it does not now track customers by their income status and doesn’t think it appropriate to track customers by their income status. To ensure that all customers have equal opportunity to engage in home energy efficiency Cascade states that it provides funding to the low-income Weatherization Assistance Program.</p> <p>NWEC believes the relationship between bill impacts and access to programs for low-income customers is not equitable. NWEC believes creation of an incentive mechanism should include detailed analysis of the positive and/or negative impacts of that mechanism on low income consumers. NWEC believes a lost margin recovery mechanism could result in an unwarranted shift in costs between customer classes or to low-income consumers. NWEC believes existing utility conservation programs for the residential class vary by utility in their accessibility to low-income customers. NWEC Provides the following list of Barriers for low-income access to conservation programs: Degraded condition of low income housing stock; restrictions on the amount of dollars available for energy-related repairs; multi-family investment has little immediate payback for the landlord. Increases in energy efficiency program budgets for low-income consumers should be at least roughly proportional to the increases in funding for energy efficiency programs for other residential consumers.</p>

Public Counsel states that any incentive mechanism should attempt to mitigate the impact on low income customers. Public Counsel believes it is important for all customers eligible for and taking part in utility-sponsored conservation to be treated equally in recovery of incentives that encourage this activity, but recognizes that low-income customers (1) feel the effects of bill increases more drastically, and (2) may not have equal access to residential DSM programs due to the cost.

CMS agrees that the transfer of conservation programs to an independent third party eliminates the utility incentives and with it, the risk of adverse impact on low-income customers.

NW Natural offers a low income energy efficiency program because NW Natural concluded low-income customers may have less ability to take advantage of utility-sponsored conservation incentives. This allows low-income customers to access either the conventional energy efficiency program or the low-income program.

NWIGU recommends that the commission wait till the conclusion of the Avista collaborative on low-income conservation before deciding a policy on this issue.

For the Energy Projects response see issue 11.

<b>Consolidated Issue list</b>	<b>COMMENTS</b>
<p><b>13. Impact on Utility Incentives.</b> 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?</p>	<p>PSE concludes that allowing the full recovery of lost margins associated with conservation does not affect a utility's incentive to control its costs.</p> <p>Avista states that incentives, lost margin recovery, or other mechanisms play no role in the Company's responsibility to control costs. Avista states that the incentive to control costs between rate cases for the benefit of the shareholder is there with or without decoupling.</p> <p>Cascade states that a company always has an incentive to control costs but that a mechanism that requires that utility to be below its authorized rate of return before it is allowed to recover lost margin creates a disincentive for utilities to pursue operational efficiencies that control costs. Cascade states that it sees no link between PGA costs and lost margin.</p> <p>CMS does not believe the recovery of lost margin due to conservation should influence a utility's efforts to control costs.</p> <p>NW Natural state that lost margin or decoupling mechanisms do not diminish the utility's incentive to control costs supported by the fact that decoupling mechanisms only allow recover of fixed costs in the last rate case which requires a utility to control costs after rates are set with or without a decoupling mechanism.</p> <p>NWIGU concludes that lost margin mechanism does not create incentives to control costs by themselves and recommends an earnings sharing mechanism in conjunction with any lost margin mechanism. NWIGU also encourages the commission to consider a natural gas purchase incentive program over a conservation incentive mechanism.</p> <p>NWEC believes the recovery of lost margin does not provide an additional incentive for the utility to control costs. NWEC believes a fully-reconciled PGA has no incentive to minimize gas costs, regardless of what is done with conservation. NWEC states that eliminating or reducing the customers' share of the PGA would be the best way to increase incentives for utilities to more effectively manage gas costs. NWEC considers and supplies cites supporting the opinion that fully-reconciled fuel, purchased power, and purchased gas costs are well-recognized as powerful incentives for utilities to increase sales volumes.</p>

Public Counsel disagrees stating that recover of lost margins reduces the incentive for the utility to control costs because the lost margin mechanism stabilizes company revenue regardless of management action. A PGA already reduces cost-control incentives by passing natural gas commodity costs directly to the customer.

The Energy Project can see how lost margin recovery might lead a utility to be less rigorous about controlling costs, depending what the recovery is based on and how it is calculated. In part because of this issue, the Energy Project concludes that decoupling mechanisms should be sorted out in general rate cases.

ICNU states that decoupling leads to poor utility management. It does not provide any incentive to control costs and encourages poor management since the utility is indifferent to selling more or less electricity, and it creates an indifference to the success or failure of their customers. ICNU feels utilities promote decoupling to protect their earnings and “revenues from sales which could theoretically be related to additional conservation.” ICNU quotes Standard & Poor’s : “Decoupling’s guaranteed level of distribution revenue, regardless of actual performance, may promote mediocrity in the management of a utility and cause a decline in customer service.”

Avista responds to ICNU’s Standard & Poor’s quote, stating that the introductory paragraph to the S&P bullet point quoted by ICNU states: “Decoupling allows utilities to project cash flow more accurately and avoid much of the earnings volatility from changes to weather/economy under traditional rate mechanism.” (emphasis added) Avista points out that discussions in this Docket to date have focused primarily on addressing recovery of lost margins related to energy efficiency, and not changes in margins related to weather and the economy.



<b>Consolidated Issue list -  <u>Relationship of Incentives to  Conservation Mandates</u></b>	<b>COMMENTS</b>
<p><b>14. <i>Impact of Conservation Mandate in I-937.</i></b> 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?</p>	<p>PSE asserts that RCW 19.285.050(2) specifically states that “An investor-owned utility is entitled to recover all prudently incurred costs associated with compliance with this chapter” includes lost margins since they are “costs” of meeting the conservation target. PSE views an incentive to go beyond compliance levels as appropriate to encourage utilities to accelerate their energy efficiency acquisitions if that is possible and cost effective above the utility’s Commission-approved target. PSE states that a balanced approach of providing incentives for good performance as well as penalties for shortfalls is in the public interest.</p> <p>Avista asserts that providing for recovery of all costs, including fixed cost recovery and a return component is not an incentive and that an incentive should be calculated based on savings in excess of that required by law.</p> <p>NEEA argues that it is appropriate to provide an incentive to electric utilities despite I-937, but the size of the incentive is an issue for discussion. NEEA provides three reasons to provide incentives: 1) the target in I-937 is too low and can be met too easily, 2) the value of incenting the achievement of cost-effective conservation ahead of schedule for lost opportunity resources and 3) Conservation programs can vary in quality and incentives drive quality.</p> <p>ICNU states that Washington utilities have a strong history of aggressively investing in conservation resources and our state is a national model for conservation programs which demonstrates that it is not necessary to remove any assumed disincentives to increase investment in conservation. ICNU asserts Washington utilities currently acquire more than Washington’s share of the Northwest Power and Conservation Council’s (NPCC) assessment of their conservation potential. ICNU recommends that the Commission rely on I-937 mandates and the traditional ratemaking process rather than decoupling programs.</p>

	<p>In reply Avista states that it has aggressively pursued energy efficiency with the expectation that, at some point, ratemaking practices will be adjusted to provided recovery of these costs.</p> <p>NWEC believes it is appropriate to provide an incentive to electric utilities for conservation. Public Counsel notes the EIA already provides incentives to a utility to achieve conservation by providing the legal obligation and setting potential penalties. In its reply Public Counsel disagrees with PSE’s legal argument that because the EIA 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 offers that the language is referring to the cost specifically related to the acquisition of renewable resources or the implementation of energy efficiency programs.</p> <p>The Energy Project reasons that in the spirit of offering as much carrot as stick, providing incentives is appropriate.</p>
<p><b>14.5. State greenhouse gas emission reduction goal (70.235.020).</b> How would removing the linkage between the number of kilowatt hours sold and financial returns for utilities impact the state’s ability to meet its statutory greenhouse (GHG) emission reduction limits (RCW 70.235.020)?</p>	<p>PSE asserts that aligning customer and company interests behind energy efficiency through decoupling and incentives would have the same positive impact on greenhouse gas reductions as it would on energy efficiency savings.</p> <p>Avista believes decoupling would help achieved the GHG reductions.</p> <p>NWEC believes that removing the linkage between the number of kilowatt hours sold and financial returns for utilities will make utilities neutral to increases or decreases in the energy use of their customers and help lead to deeper commitments to energy efficiency. NWEC reasons that this in turn will yield reductions in GHG emissions, helping the state meet its statutory targets.</p> <p>The Energy Project states “Since there is nothing that currently makes the dirtiest resources the most expensive resources from a utility’s perspective, we are not confident that reducing the link between sales and financial returns necessarily rolls back the greenhouse gas contribution of the embedded coal resources. As we understand it, unless existing coal is taken out of the system, we can’t return to the 1990 levels, let alone 25% below those levels. Until the economic cost of the greenhouse gas contribution from the embedded</p>

	<p>resources are taken into the accounting, breaking this link will at best slow or, perhaps, stop the increase in greenhouse gases being contributed by substituting energy efficiency for new gas or new coal. While that is important it doesn't get us to the goal.”</p>
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Consolidated Issue list	COMMENTS
<p><b>15. Incentives to Exceed I-937 Targets.</b> 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?</p>	<p>PSE notes that the phrasing of issue 15 incorrectly presupposes that any conservation achieved above and beyond the conservation targets projected pursuant to RCW 19.285.040 would necessarily not be cost-effective. PSE asserts that the conservation field is rapidly advancing conservation and utilities should be encouraged to be vigilant for opportunities to seize upon promising developments that were not contemplated in the previous target-setting process.</p> <p>Avista states that it supports the consideration of incentives for cost-effective resource acquisition beyond that required by I-937.</p> <p>NEEA observes that by definition, ratepayers are not benefited by paying for non-cost-effective resources but incentives can be in place to promote achievement of cost-effective conservation ahead of schedule for lost opportunity resources.</p> <p>NW Natural feels that consideration of conservation that is not cost-effective should be evaluated on a case-by-case basis and the WUTC “should have the authority to consider conservation above established conservation targets.”</p> <p>Public Counsel states EIA only authorizes incentives for exceeding targets and no authority for payment of incentives for just meeting the statutory target. Further the statutory target is the identification of all achievable, cost-effective, feasible conservation and, by definition any additional conservation achieved beyond this would not be cost-effective. Public Counsel states that based on this ratepayers would not benefit from incentives that exceed targets, and instead experience negative economic impacts based on the acquisition of non cost-effective resources and they would pay the cost of whatever incentive was established.</p> <p>NWEC believes that incentives to exceed a biennial target would still promote acquisition of cost effective energy efficiency. NWEC does not agree that such incentives would promote the pursuit of non-cost-effective conservation.</p> <p>The Energy Project considers the conclusion in the question over simplistic. The Energy Project points to the continuous discovery of new conservation measures and underestimates of achievable conservation as problems that still exist even with I-937.</p>

Commission Questions	COMMENTS
<p><i>16. Impact of Disincentive.</i> 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?</p>	<p>PSE asserts that the performance of utility energy efficiency programs relative to the NPCC’s assessment of conservation potential is not indicative of whether or not a disincentive for conservation exists.</p> <p>Avista perceives that the potential exists for a disincentive to over-achieve a Company’s two-year target under I-937. Avista suggests that over achievement of the target in the first two year period could lead to under achievement in the second two year period resulting in penalties.</p> <p>NWEC questions the premise that IOUs currently acquire more than their share of the Council’s conservation assessment and reference Docket No. UE-100176 Docket No. UE-100170 and Docket No. UE-100177. NWEC suggests reframing this question to focus on whether a disincentive to conservation exists given that electric utilities have been ramping up their energy efficiency investments. NWEC concludes the answer is yes, and now more than ever.</p> <p>The Energy Project expresses three reservations:</p> <ul style="list-style-type: none"> <li>• The first statement in this issue may not be actually accurate.</li> <li>• Second, exceeding the NPCC’s proportionate share may not reflect so much on the lack of disincentive as a conservative estimate of what is “achievable.”</li> <li>• Third, even if there is more conservation than the NPCC target, it is in the utility customers’ best interests to do achieve more that the target for a myriad of reasons.</li> </ul>

Consolidated Issue list	COMMENTS
<p><i>17. Natural Gas Planning.</i> 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?</p>	<p>PSE states that a "least cost" plan means demand-side resources that cost less than the supply-side alternatives are part of the least cost solution it pursues.</p> <p>Avista agrees that the gas planning rule does require that the utility pursue all cost-effective conservation. Avista posits that conservation incentives promote more successful conservation programs.</p> <p>CMS concludes that the rule does make that requirement and advises that the commission transfer conservation programs to an independent third provider.</p> <p>NW Natural responds yes, there is such a requirement. WAC 480-90-238(1) states the mandate to acquire the lowest reasonable cost resource as they are defined in WAC 480-90-238(2)(b).</p> <p>Public Counsel concludes it is difficult to find evidence of any disincentive. Public Counsel states that companies have not made use of the rate of return incentive provided for in RCW 80.28.025 and companies widely advertise their commitment to and achievement of conservation and renewable programs to their customers and to the public at large.</p> <p>NWEC believes that since the IRP does not bind the utility, it does not have the same effect of requiring the utility to pursue all cost effective conservation.</p> <p>Public Counsel states that as a general proposition, gas utilities are required to pursue all cost-effective conservation, insofar as it is achievable and feasible, as these limitations are provided for in the rule. Public Counsel notes that Subsection (2)(b) provides a number of considerations that must be taken into account as part of the determination of what is the least-cost, cost-effective resource mix.</p> <p>NWIGU states that utilities should not be rewarded for conservation they are legally required to pursue in Washington.</p> <p>The Energy Project believes the rule contain that requirement.</p>

<b><u>Consolidated Issue list – Evaluation, Measurement and Verification</u></b>	<b>COMMENTS</b>
<p>18. <i>Use Per Customer as a Metric.</i> Is use-per-customer for individual rate classes a useful metric for identifying conservation effects?</p>	<p>PSE states that changes over time in weather-normalized use per customer would not separate the effects of the various factors that may cause energy use to increase or decrease, and would certainly not be a way to separately identify or measure the specific effects from conservation.</p> <p>Avista agrees that applying use-per-customer as a metric for measuring energy efficiency results would provide the opportunity to capture energy efficiency related to programmatic and non-programmatic efforts. Avista cautions that it is important to bear in mind that factors other than energy efficiency can affect use per customer.</p> <p>PacifiCorp notes that changes in use-per-customer occur for a variety of reasons and therefore use-per-customers is not necessarily an indication of whether or not a customer is conserving energy. PacifiCorp also notes that the majority of studies indicate that per household energy (electrical) use is increasing due to proliferation of energy intensive home electronics and appliances and increased penetration of central air conditioning.</p> <p>Cascade considers use-per-customer for an individual rate class to be the best metric for identifying conservation since it captures all conservation efforts.</p> <p>NWEC believes use-per-customer is a useful metric for identifying conservation effects. However, NWEC suggests that changes in use per customer compared with the long-term trend of use per customer (last 10 years or so, weather normalized sales) may be a more useful metric.</p> <p>Public Counsel does not agree that use-per-customer is a useful metric for identifying conservation effects because it cannot be solely attributable to the effects of utility-sponsored DSM or conservation and ignores offsetting elements that may also have an impact. In addition Public Counsel believes the downward trend in gas use per customer is</p>

driven by replacement of inefficient older home appliances, improved codes and standards, and ratepayers' independently funded efforts to conserve.

NEEA considers this an attractive performance metric but fairly intractable to measure.

CMS states that a use-per-customer metric would not work among large customers.

NW Natural considers use per customer to be good metric.

The Energy Project does not agree that use-per-customers is a good metric, in and of itself.

NWIGU recommends utilizing the work that will be completed in the Avista collaborative required by order in Avista's last completed general rate case.



Consolidated Issue list -	COMMENTS
<p><b>19. Load Forecasting.</b> Load forecasting is a key input for calculating conservation effects. How can load forecasting become more reliable? How does conservation get accurately incorporated into a company's load forecast?</p>	<p>PSE agrees that understanding the relative effects of conservation requires a reliable baseline load forecast against which the forecasted conservation can be compared.</p> <p>Avista states that it includes conservation in the Company's load forecast.</p> <p>PacifiCorp states that it reduces its load forecast by an estimate of future load reductions from existing conservation programs that are captured in the historical load data. PacifiCorp asserts that this adjustment eliminates any double-counting from combining the separate load and conservation forecasts.</p> <p>NEEA states that forecasts can be use to help determine the conservation forecast and should be removed from the baseline in subsequent forecasts.</p> <p>Public Counsel states that this may be a broader issue and that it would be helpful to a gain a better understanding as to how the utilities take conservation effects into account in their load forecasts, and how that relates to the utilities' own estimation of their achievable conservation potential.</p> <p>NW Natural states that forecasting will never be exact and they regularly update and refine their forecast in the course of their bi-annual IRP process and annual PGA filing. They include conservation in their load forecast as part of the IRP. They determine both technical and achievable potential cost-effective DSM and deducted it from their load requirement.</p>

Consolidated Issue list -	COMMENTS
<p>20. <i>Methods for EM&amp;V</i>. Should the Commission establish a method, or general guidelines for an evaluation, measurement and verification (EM&amp;V) methodology?</p> <p>a. What role should a third party evaluator of EM&amp;V play?</p> <p>b. Are EM&amp;V methods accurate enough to use the history of individual customer usage as the basis for determining the payments in an incentive mechanism?</p> <p>c. What role should the Regional Technical Forum play in EM&amp;V issues?</p>	<p>PSE states that EM&amp;V responsibility should remain with utilities, coupled with review and input by each utility’s stakeholder advisory group.</p> <p>NEEA recognizes the Commissions role in setting standards by which achievements are measured for purposes of regulatory incentives but recommends the commission rely on existing sources for such standards where possible and cites several.</p> <p>CMS directs the commission to the grant agreement between the energy Trust of Oregon and the Oregon Public utility commission for examples of EM&amp;V oversight.</p> <p>Public Counsel agrees that a collaborative established by the Commission to adopt a set of EM&amp;V protocols and/or methodologies for all Washington utilities, both electric and gas, would serve to standardize and improve utility EM&amp;V methods and ensure confidence and transparency in savings associated with utility conservation programs. Public Counsel believes an EM&amp;V expert and a facilitator should be retained to assist as either part of a rulemaking or a generic proceeding. In its reply, Public Counsel states that 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.</p> <p>NWEC believes the Commission should establish a method or general guidelines for EM&amp;V. It is very important to judge utility conservation efforts using the same protocols.</p> <p>NEEA considers a third party evaluator to be useful but that effective EM&amp;V depends on a process that is transparent, includes oversight, and in which a knowledgeable staff member of the energy efficiency organization [utility’s staff in this case] has responsibility for ensuring objective and replicable results.</p>

**Part a**

PSE asserts that EM&V can be effectively carried out by a utility's in-house staff following acceptable protocols, practices, and oversight. PSE states that the development of acceptable methods or guidelines for EM&V are more important than proscribing who should do the work.

Avista supports sufficient third party evaluation to affirm that the DSM shown by a utility's EM&V results occurred.

PacifiCorp states that the role a third party evaluator plays in EM&V depends on the program. PacifiCorp supports utilities determining when to use a third party evaluator.

NWN agrees that a third party evaluator may be used to verify deemed savings by performing pre-and post-bill analysis. NWN cautions that any requirement to use a third party should consider the cost this will incur.

NWEC believes third party evaluation of EM&V is very important to ensure performance and to provide critical feedback on programs to allow timely midcourse corrections, if necessary. NWEC notes that the commission recently set conditions with respect to Avista on EM&V.

Public Counsel believes a third-party evaluator of EM&V provides an unbiased, independent and expert opinion of the savings claimed for the program under review. The third-party acts as a neutral, independent evaluator and verifier of the savings associated with utility DSM program and Public Counsel feels priority should be placed on utilizing third party evaluators to examine the largest programs, in terms of savings and expenditures.

NEEA considers a third party evaluator to be useful but that effective EM&V depends on a process that is transparent, includes oversight, and in which a knowledgeable staff member of the energy efficiency organization [utility's staff in this case] has responsibility for ensuring objective and replicable results.

Cascade recommends that the state establish a third party evaluator to develop a formal list of deemed therm savings estimates by climate zone for use by all utilities.

The Energy Project believes it would be good to standardize what is expected from the process for EM&V and that the ultimate examination of a specific utility's programs should be done by a third party.

**Part b**

PSE states that the history of customer usage is not always the most appropriate basis for evaluating program impacts.

Avista supports bill verification as one tool for determining energy efficiency savings but does not support relying on it as the primary and/or only tool.

NEEA considers EM&V methods to be accurate and reliable enough to use for certain types of incentive mechanisms.

NWEC believes EM&V methods can be very effective in determining savings. NWEC states that their use as a basis for the incentive depends on the design of the incentive mechanism. NWEC notes, though, that history of customer usage may not provide a complete picture for purposes of designing an incentive mechanism.

NW Natural agrees that using historical usage as a baseline is appropriate. NW Natural recommends that when studying savings, the program participants' usage data should be compared with a control group's so the analysis of therms saved can be adjusted for any anomalies in usage as determined by looking at the control groups historic and current usage data.

Public Counsel does not agree. Public Counsel sees EM&V as evolving and usage per customer as not a useful metric.

**Part c**

PSE states that the Regional Technical Forum (RTF) should continue to play a key role, particularly with respect to vetting and establishing “deemed” savings for measures in wide use throughout the region.

PacifiCorp considers the regional technical forum as one of many recognized sources providing estimates of savings.

Avista hopes that the RTF will be front and center with EM&V issues and supports its processes, findings and results.

NEEA believes that the RTF could play an even greater role in helping move the region toward consistent EM&V protocols.

NWEC believes the RTF should play a critical role in EM&V issues, and urges the Commission to approve IOU funding of the RTF. NWEC considers the RTF to have developed simple, consistent reporting formats and that the RTF has only just begun to consider expanding its role into process and impact evaluation of more custom measures and programs.

PacifiCorp finds it reasonable to establish general guidelines as it provides clarity and consistency and also adds certainty but does not find using a one-size fits all approach for all EM&V as appropriate.

Public Counsel states that the RTF plays an important role but it is not clear whether they have resources or the organizational structure to effectively address EM&V issues and they do not address natural gas efficiency measures.

NW Natural has not worked with the RTF and has no opinion on what its role should be.

Consolidated Issue list -	COMMENTS
<p><b>21. <i>Impact on Cost-Effectiveness of Conservation Measures.</i></b> 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?</p>	<p>PSE states that lost margin is not related to the total resource cost tests (TRC) and should not be included in the TRC.</p> <p>Avista reasons that inasmuch as lost margin recovery mechanisms reflect the recovery of Commission approved fixed costs, the costs should not influence the evaluation of DSM program cost-effectiveness.</p> <p>NEEA believes that if the Commission agrees that incentives to cover lost margin are necessary to achieve conservation, then those incentives are part of the cost of achieving the resource and should be included in the TRC. Citing a paper by Cappers, et al, NEEA notes one example of the inclusion of incentive payments in the TRC (albeit, high incentives) as driving the TRC below the cost effective ratio.</p> <p>NW Natural feels that it would be inappropriate to include costs for lost margin in the TRC test since lost margin includes costs unrelated to demand side management.</p> <p>NWEC believes the cost of lost margin recovery should not be included in the cost effectiveness test because it is not a cost (land, labor, capital, entrepreneurship) - it is a reallocation of responsibility for cost recovery for allowable costs, restoring revenues to cover costs that exist with or without the conservation measure implementation, but are not fully recovered with conservation implementation</p> <p>Public Counsel recommends further consideration of this subject. Public Counsel reasons that if the cost/benefit ratios of the Utility Cost (UC) and the Total Resource Cost (TRC) are close to the 1.0 threshold, the additional cost of lost margin recovery or incentive payments could be enough to cause the entire portfolio to fail the cost effectiveness standards. In its reply, Public Counsel notes the claim that the decoupling mechanism would have no material impact on business risk creates an inconsistency: conservation increases risks by seriously harming returns and cost recovery, but the supposed remedy – decoupling – has no material impact on business risk.</p>

The Energy Project believes that they should not be included and that their inclusion would substantially reduce the amount of conservation that was determined to be cost-effective.

NWIGU does not recommend inclusion of lost margin recovery in the cost-effectiveness test but does recommend that the recovery costs be tracked separately. In its reply comments, NWIGU proposes that If lost margin is allowed for recovery in rates for gas conservation programs, then the cost as actually allowed for rate recovery for each utility should be analyzed to determine if its inclusion impacts the cost effectiveness of natural gas conservation measures

<b><u>Consolidated Issue list- Relationship of Conservation Incentives to Utility Return on Equity</u></b>	<b>COMMENT</b>
<p>22. <i>Effect of Incentive Mechanism on Allowed Return on Equity</i>. Should adoption of an incentive or lost margin/decoupling mechanism require a downward adjustment in the utility's return on equity?</p>	<p>PSE asserts that an incentive mechanism or a lost margin/decoupling mechanism does not materially impact a company's business risk, therefore should not, <i>a priori</i>, require a downward adjustment in the utility's return on equity. PSE asserts that it is possible to assemble a proxy group of utilities with decoupling (and similar) mechanisms to directly calculate the cost of capital rather than make an ad hoc adjustment.</p> <p>Avista does not agree that an incentive or lost margin/decoupling mechanism requires a downward adjustment in the utility's return on equity.</p> <p>Cascade doesn't agree that the adoption of an incentive or lost margin/decoupling mechanism should require a reduction to the utility's return on equity but the adoption allows the utility to promote conservation and not file rate cases frequently.</p> <p>CMS states that a utility's rate of return should be reduced the more the company is protected from business risks.</p> <p>NW Natural does not believe adoption of an incentive or lost margin/decoupling mechanism should include a downward adjustment to the utility's rate of return. NW Natural states a utility's allowed rate of return on equity should be determined with reference to an appropriate peer group of utilities. They state a utility without decoupling should be awarded a higher return on equity than a group of peers without decoupling.</p> <p>ICNU believes that decoupling shifts the risk of changes in load from the utility shareholders to the customer and the Commission should reduce the utility's authorized rate of return to reflect this shift. ICNU points out that the Commission has repeatedly recognized this shift and rating agencies recognize the reduced risk and view decoupling as a positive development from a credit perspective.</p>



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

Public Counsel states that decoupling or lost margin mechanisms shift risk from shareholders to ratepayers by stabilizing utility revenue, effectively guaranteeing a certain level of cost recovery and causes the shifting of risk to ratepayers. In contrast, Public Counsel states that an incentive mechanism does not necessarily require a downward adjustment to the return on equity if the incentive is independent of any calculation of lost margin and not designed to replace lost margin.

The Energy Project recommends that the utility's return on equity should reflect the risk the utility undertakes; if an incentive or lost margin recovery lowers that risk, there should be a commensurate lowering of ROE.

NWUGI states that it is beyond dispute that any mechanism that makes a utility whole for losses in conservation revenue makes the utility less risky. In its reply, NWIGU adds that in doing a proper analysis necessary to develop a properly structured mechanism would include complete scrutiny of the utility's operations, the development of a sharing and quality control mechanism, the determination of the appropriate revenue requirement benchmark, and the measure or measures by which the Company's performance would be judged.

Consolidated Issue list	COMMENTS
<p><b>23. Incentive Rate of Return.</b>  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?</p>	<p>PSE allows that offering an incentive rate of return for rate based conservation could be one way of motivating utilities to be innovative and progressive in seeking to accelerate the pace of their conservation investment if the unrecovered fixed cost issue is addressed first.</p> <p>Avista asserts that a utility should have the option of requesting to expense or capitalize its energy efficiency programs.</p> <p>As CMS does not believe utilities should administer conservation programs. That said, CMS concludes that since the money is collected from the ratepayers the company should not get an incentive rate of return.</p> <p>NW Natural state that without decoupling a utility should receive an increased rate of return for promoting conservation. NW Natural believes utilities should be compensated for the risk of reducing demand for their product. NW Natural recommends that conservation programs funded by the utility prior to collection of funds from ratepayers should be allowed a return until collected.</p> <p>Aside from RCW 80.28.025 which allows for rate of return enhancement, Public Counsel concludes it is not clear that there is a compelling rationale for increasing rate of return as a reward for sponsoring and administering conservation. Public Counsel notes that allowing a return to a utility on ratepayer monies provided for conservation would be inequitable, and would not be appropriate. Public Counsel considers it is speculative at best whether the amount of energy efficiency offered by the utility would increase under either of the above approaches. Public Counsel considers a flaw in the traditional decoupling proposals have been the absence of any enforceable commitment to achieve specific incremental amounts of conservation above the status quo in return for the benefits of decoupling. Public Counsel concludes that offering a “bonus” rate of return to a utility with no requirement of tangible improvement in conservation achievement is a misuse of ratepayer funds.</p> <p>NWEC believes utilities should not earn a return on monies collected from ratepayers to fund its conservation programs.</p>

The Energy Project reasons that if a utility needs to borrow capital in order to build supply to serve its ratepayers, they earn a rate of return on that investment, even though ratepayers ultimately pay the bill, so if the conservation program is capitalized, it should be treated the same. The Energy Project does not believe the utility should receive both a return on conservation investment it makes and an incentive payment.

NWIGU states that whether or not a utility has a recovery mechanism it is required to pursue conservation as a matter of law. In its reply comments, NWIGU states that there is no justification for increasing the rate of return as a reward for sponsoring and administering conservation. NWIGU also states its support for Public Counsel's argument that it would be inequitable and inappropriate to allow a return to a utility on ratepayer monies provided for conservation.

Consolidated Issue list	COMMENTS
<p>24. <b>Other Issues.</b> Comment on any other issue relevant to this inquiry that is not covered above.</p>	<p>PSE asserts that even if an alternative conservation delivery mechanism such as an “Energy Trust of Oregon” model is adopted there will continue to be lost margin.</p> <p><b><u>PSE suggests the following rule language:</u></b></p> <p>WAC 480-100-xxx.  Upon application of an electrical or gas company, the Commission shall approve rate adjustment mechanisms to: (i) provide full and timely recovery of all prudently incurred cost-effective expenditures for conservation; and (ii) ensure that utilities recover nonfuel revenue requirements that would have been recovered absent conservation savings.</p> <p>The Avista states that it believes it is important that the Commission make a determination in this proceeding on at least four fundamental questions. First, does a utility experience a reduction in the recovery of its fixed costs of providing service to customers as a direct result of successful implementation of energy efficiency programs? Second, should some adjustment be made in current ratemaking practice to restore recovery of these fixed costs? Third, should some form of incentive be provided to utilities to achieve energy efficiency savings over and above the level required by the Energy Independence Act (EIA)? And fourth, is it appropriate to allow utilities to finance and capitalize all or a portion of the energy efficiency costs, and recover the costs over a period of time rather than in the first year?</p> <p>Avista states that it believes an adjustment should be made, whether in the form of a pro forma adjustment in a rate case or some type of mechanism such as decoupling, to restore recovery of the fixed costs. Avista considers the reduction in load resulting from the required energy efficiency under the EIA as a “known and measurable” event and that in order for revenues and expenses to be properly matched for ratemaking purposes, it is necessary to make some kind of adjustment for the known reduction in energy sales that will occur, otherwise the matching principle is violated. Avista states that unless some form of lost margin recovery is provided, the retail rates established by the Commission in a general rate case would not be sufficient to recover the Company’s costs. Avista concludes that, absent the provision for lost margin recovery, there would be a conflict between the legal requirement to establish rates that are “just, reasonable or sufficient,” (RCW 80.28.020), and</p>

the requirement for the Company to achieve the energy savings – a mismatch for ratemaking purposes. The legal requirements of both the EIA and RCW 80.28.020 must be satisfied.

Avista asserts that lost margin recovery is not single-issue ratemaking. Avista explains that when base rates are set in a general rate case, there is actually a failure to properly match revenues and expenses, because the required, known decline in sales revenues resulting from energy efficiency is not included in setting retail rates.

In response to Public Counsel claims that there is no evidence of a shortfall in cost recovery, Avista states its actual return on equity in Washington for electric operations was 7.15% in 2007, 7.18% in 2008, and 7.20% in 2009 and that its actual ROE for Washington natural gas operations was 7.30% in 2007, 7.44% in 2008, and 6.66% in 2009. Avista concludes that since all of these returns are well below the Commission-authorized ROE of over 10% for these years, the absence of lost margin recovery related to energy efficiency represents a compounding of the under recovery of costs to serve customers in the State of Washington.

NEEA states that it is concerned that responses to diverse sets of specific questions in this rulemaking do not encourage a vision of an integrated approach to a shareholder incentive mechanism.

NEEA proposes a mechanism based on the assumption that the purpose of the discussion of incentive mechanisms is to find a way to motivate Washington IOUs to become even more proactive and focused on conservation than is currently required by law. NEEA's proposal outlined in their comments is based on determining an absolute dollar amount maximum that can be earned in increments as conservation accomplishments increase. NEEA suggests that a large fraction of the reward structure should be dependent on savings of kWh in excess of the requirements under I-937. NEEA suggests another fraction would be dependent on creating market effects or progress toward long term market transformation, and other fractions could be determined by other strategic policy goals, e.g., reaching all customer segments, obtaining more lost opportunity resources, involving renters, low income and hard to reach customers, etc.

In its reply, Public Counsel rejects the use of gross savings in NEEA's straw incentive proposal. Public Counsel states that NEEA's gross savings would include savings from codes and standards as applied to new homes even though the utility's programs did not contribute to those savings.

NWIGU requests that the commission examine Cascade's decoupling mechanism in Oregon as it considers mechanisms in Washington state.

NWEC provides the following recommendations:

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