

JENNIFER GROSS
Tariff and Regulatory Compliance
Tel: 503.226.4211 ext. 3590
Fax: 503.721.2516
email: jgg@nwnatural.com



August 31, 2012

VIA ELECTRONIC FILING

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

Re: UG-121207 - NW Natural's Responses in the Commission's Investigation into Natural Gas Conservation Programs

Dear Mr. Danner:

Northwest Natural Gas Company, dba NW Natural ("NW Natural" or the "Company"), hereby submits the following answers to the Washington Utilities and Transportation Commission's ("Commission") questions issued in Docket No. UG-121207, Investigation into Natural Gas Conservation Programs.

NW Natural commends the Commission for opening this investigation at this time. Due to advances in the ability to extract gas from shale deposits, current gas supplies are abundant and prices are lower than previously forecast. Also, recent impact studies have revealed that some energy efficiency measures are not saving as many therms as previously assumed. As a result of these two factors, energy efficiency measures that were once a good, low cost investment, are no longer cost effective. While the Company values energy efficiency, it also values making the most economic investment on behalf of its customers. But stopping and starting energy efficiency programs as gas prices rise and fall may have other unintended consequences. Therefore, the Company believes this investigation is a well-timed opportunity to look at natural gas energy efficiency programs and how they are valued.

NW Natural's responses to the Commission's questions comply with the parameters for utility investments. As defined by Washington Administrative Code

("WAC") 480-90-238(b), a utility should invest ratepayer funds in least cost resources, which are:

the lowest cost mix of resources determined through a detailed and consistent analysis of a wide range of commercially available sources. At a minimum, this analysis must consider resource costs, market-volatility risks, demand-side resource uncertainties, the risks imposed on ratepayers, resource effect on system operations, public policies regarding resource preference adopted by Washington state or the federal government, the cost of risks associated with environmental effects including emissions of carbon dioxide, and the need for security of supply.

NW Natural's responses to the Commissions' two questions comply with current regulation and do not, at this time or in this forum, advocate imposing costs onto ratepayers for benefits or externalities that are outside the boundaries authorized through law or administrative code. While RCW 80.01160 and RCW 80.04.001 grant the Commission broad authority, the Company believes that a significant reassignment of costs to ratepayers is a policy decision best made in the legislature.

Below are the Commission's questions followed by the Company's responses.

- ***What are the appropriate assumptions or factors to include in natural gas avoided cost calculations?***

In accordance with WAC 480-90-238(b), demand side management ("DSM") is the appropriate, least cost resource to acquire when an energy efficiency measure costs less than the therm of gas that would otherwise have been needed. Serving additional demand may require costly capital investments that could be postponed through energy efficiency investments. To understand the degree to which a utility should invest in DSM, the costs of the next therm saved must be compared on an equal basis with the next therm of gas supplied. The avoided cost is intended to provide the value for the next therm of gas supplied.

The Company's current avoided cost is comprised of the following costs:

- The long term gas price forecast compiled from Intercontinental Exchange (ICE) futures and a consultant's gas price forecast;
- Gas storage carrying costs for inventory;
- Upstream variable transmission costs;
- Peak related on-system transmission costs; and
- A 10% adder for unidentified environmental benefits, as recommended by the Northwest Power and Conservation Council ("NWPPCC")

The Company is open to discussing whether or not its current approach accurately uses the true avoided cost when assessing efficiency measures. In contemplating this question, the Company is considering whether or not it would be

more accurate to use a long run marginal cost as opposed to the short run marginal cost currently used for the commodity portion of our avoided cost. The Company believes the value of DSM may currently be understated because the avoided cost applies today's value while the savings from efficiency measures accrue over time. To the extent that the long run marginal cost in the avoided cost forecast is greater than the short run marginal cost in the early years, then the full value of the measure over time may not be accounted for in the current analysis.

The Company is also open to discussing whether or not the 10% adder for unidentified environmental benefits included in accordance with the NWPCC's guidance is sufficient or if instead of this adder, the avoided cost should include real and quantifiable environmental costs.

While the Company is open to discussing ways to re-evaluate its avoided costs, it is worth noting that the Company's 2011 Modified IRP included a sensitivity analysis on its avoided cost that showed that a 39% increase to the avoided cost only increased the total DSM achievable potential by 4%-- which represents approximately 0.5% of the Company's total portfolio of resources. This tells us that increasing the value of avoided cost will not necessarily tip the scales such that the gas measures in question will be cost effective again.

- ***Should companies use a combination of cost tests in evaluating the cost-effectiveness of natural gas conservation programs?***

Five benefit cost ratio tests are identified in the California Standard Practices Manual. Each one represents a specific stakeholder's view: participant, ratepayer impact, utility, societal, and total resource. Each test assumes a measure is cost effective for its perspective when the present value of benefits exceeds the present value of costs.

For energy efficiency to be a least cost resource for its customers, NW Natural recommends applying the Total Resource Cost ("TRC") test at the portfolio level. The TRC is the present value of benefits divided by costs, where costs and benefits are as listed below:

TOTAL RESOURCE COST	
Benefits	Costs
<ul style="list-style-type: none"> • Avoided costs • Tax credits • Decreased O&M • Quantifiable additional benefits to the participant or utility system 	<ul style="list-style-type: none"> • EE Measure hardware and installation cost • Program expenses (administration, program delivery) • Increased O&M

Energy Trust of Oregon (“Energy Trust”), who administers the Company’s programs in both Oregon and Washington, uses the TRC test at the measure level to determine if it should be included in the portfolio of offerings. In Oregon, specific exceptions to meeting the TRC are allowed. For example, if measure costs are expected to go down with market transformation, a measure may be included in the program offering even if it has a TRC of less than 1. The Company would not advocate a prescriptive application at the measure level without an allowance for exclusions. But generally, the TRC provides good guidance on whether or not to offer an incentive on a measure.

The TRC is best applied at the program and portfolio level to ensure at a comprehensive level that all costs incurred by participants, customer, and the utility are more than offset by the benefits to the utility system. If TRC is not strictly adhered to at a measure level but set at the portfolio level, there could be tradeoffs within the portfolio where some measures that do not pass are supported by those that do. Under this framework, the overall mix of measures could be managed to produce a TRC cost ratio >1.0. An adjustment to savings acquired for free-riders or spillover is not applied to this test. Maintaining a TRC >1.0 ensures that the funds spent on energy efficiency will result in a net benefit for ratepayers.

The second benefit cost ratio test applied to NW Natural’s Oregon energy efficiency programs is the Utility Cost Test (“UCT”). Like the TRC, the UCT is the benefits to the utility system divided by cost over the life of the measure, but the UCT defines cost and benefits as follows:

Utility Cost Test	
Benefits	Costs
<ul style="list-style-type: none">• Avoided Costs of net therms saved	<ul style="list-style-type: none">• Utility measure cost (incentive)• Program management and administration costs

The UCT is a useful tool for both budgeting and determining the appropriate incentive level through measure level analysis with incentive cost only, building up to program level analysis with administration and delivery costs included. The incentive level should be adjusted so that the benefit cost ratio is no less than one. Further, to ensure that the incentive level is appropriate and that the program is not expending funds on customers who would invest in the measure absent the program, it is important to apply an adjustment for free riders to this the UCT, and when a free rider adjustment is applied, an adjustment for spillover should also be made.

The application of the UTC at the measure level and then the TRC at the portfolio level ensures that ratepayer dollars are being used efficiently in the purchase and long term planning for demand side management acquisition.

- ***The Commission also seeks Statements of Proposed Issues from interested parties addressing what the Commission should consider concerning the planning and implementation of natural gas conservation programs.***

Below are NW Natural's proposed issues concerning the planning and implementation of natural gas conservation programs. The Company uses this opportunity to raise policy related questions that likely need to be addressed through legislation:

- 1) Should the Commission consider allowing exclusions from the cost effectiveness standard for specific purposes such as to allow investments in market transformation; to prevent the stopping and starting of certain measures that are vulnerable to changing gas or measure costs; or to allow parity of offerings among competing utilities in a given service territory? The Public Utility Commission of Oregon allowed for exclusions from cost effectiveness tests in its Order No. 94-590. Based on its experience in Oregon, NW Natural believes that an allowance for exceptions is useful to move the market and to continue investments in energy efficiency despite changing economic conditions.
- 2) How should low income weatherization programs be valued? Low Income weatherization programs provide benefits that are not quantified in traditional cost effectiveness tests. It may be difficult to quantify the benefits and further, to assign the costs of these benefits to ratepayers without legislation.
- 3) Is there a risk or concern that natural gas programs will continue to be vulnerable to failing cost effectiveness standards even after the Commission has clarified the avoided cost calculation and the cost effectiveness tests should be applied to DSM investments? Should all or any part of energy efficiency offerings be explicitly part of basic utility service, and if so, to what degree? If certain measures were considered "basic utility service", how should programs be designed that offer these services?
- 4) Since market conditions can change and energy efficiency programs rely on customer response, the Company would recommend that the Commission consider annual DSM acquisition goals to be best estimates rather than hard targets.

NW Natural appreciates the opportunity to respond to this inquiry and looks forward to participating in the Commission workshop planned for October 19, 2012.

UG-121207 – WUTC Investigation into Natural Gas Conservation Programs

August 31, 2012

Page 6 of 6

Please contact me at (503)226-4211, extension 3590, if you have any questions.

Sincerely,

/s/ Jennifer Gross

Jennifer Gross
Rates and Regulatory Affairs