NW Natural

May 27, 2008

Mark S. Dodson
Chief Executive Officer

Commissioner Sidran

Enclosed are two documents describing our attempt to educate ratepayers locally and at the national level about the importance of supply, efficiency and the benefit of the direct use of natural gas. Since you have put a lot of emphasis on direct use I thought you would be interested in the joint NRDC and AGA release which Ralph Cavanagh and I had scheduled in Portland at the NARUC meeting on July 21. Since Ralph could not

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make that one - they scheduled another on May 22 in Washington D.C. That day was our annual shareholder meeting so Lacy Downes took my place and someone from NRDC New York will come to Portland on July 21.

Hope everything is going well for you all

Mark Dodson

NW Natural

May 27, 2008

Mark S. Dodson
Chief Executive Officer

Commissioner Oshie

Enclosed are the two packages we have passed out in Salem to try to encourage an examination of supply and efficiency. The first one we did locally and the press release on May 22 is something I have been working on since the beginning of the year on efficiency. It follows the same pattern that Ralph Lavenaugh and I followed in July 2007 when Marilyn Showalter was so surprised at the Salt Lake meeting in July.

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Ralph and I were going to roll it out in Portland on July 21 but Ralph had a conflict so I will do the roll out in Salem as planned and Ralph did the one with Gary Downey filing in for me last week. Last week was our annual shareholder meeting so I had a conflict on May 27.

All of these are efforts to inform the ratepayers and the public that we need to make every effort now to do a lot of the easy efficiency things before it gets even harder in the future. Best wishes

Mark

NW Natural

May 27, 2008

Mark S. Dodson
Chief Executive Officer

Commissioner Jones

Hope everything is going well. Enclosed are two statements on supply of gas and the need for more offering. The first is a local effort by us to inform key opinion leaders in the Pacific Northwest. The other is a joint effort at a national level by AGA and NRDC. Ralph Cavanagh and I worked on the first joint statement four years ago and

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worked on another one this year focusing on offering and direct use. I will present it with NRDC as well at the NARUC in Portland on July 21 as well.

Hope to see in Montana, next month

Mark

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May 2008

Dear friends:

We are writing once again to update you on the significant changes we see coming for the energy industry and its customers – changes that could greatly affect the prices we all pay for natural gas and electricity.

As the nation nears consensus on global warming, there's a great deal of enthusiasm for progressive change. Already, many Western states have agreed on goals for reducing greenhouse gas emissions in an effort to slow climate change. But in addition to boosting investment in renewables and energy efficiency, new carbon-constraint policies will cause a much greater reliance on natural gas as we move away from coal-fired electric generation.

NW Natural does not sell gas for large-scale electric generation. Nor do we make a profit on the gas we sell to customers – we pass the cost of the gas commodity on directly to customers, without a markup. But we do have a big interest in these issues because it's important to us that our customers continue to have access to affordable energy.

Over the last seven years, natural gas prices have tripled in the Northwest. There are two principal reasons for this: greater use of natural gas for power generation and greater competition for Canadian gas.

Impending climate change legislation will intensify the demand side of this equation. Without new gas supplies, we may see a supply/demand imbalance that could send prices much higher. Such price hikes would affect all energy customers.

This situation concerns many in both the natural gas and electric industries. That's why you are reading so much about new natural gas infrastructure projects – whether it's proposed pipelines, storage projects or liquefied natural gas terminals.

It's our belief that having options – both access to LNG and Rocky Mountain gas – is our best strategy for keeping natural gas affordable for our customers, and maintaining our region's long-standing advantage of lower cost energy.

The nation and the Northwest face complex energy and environmental challenges. While we don't claim to have simple answers, we do feel responsible as your natural gas utility to pass on information about the trends and issues that could affect your energy bills. To that end, we've enclosed a publication that provides a summary of energy supply, demand and price challenges facing the Northwest.

No doubt, you will continue to read and hear about these issues in the media. As Congress gets closer to passing carbon-reduction legislation and the need for new gas infrastructure intensifies, we will keep you informed through letters like these, community meetings and Web site updates.

In the meantime, if you have questions about any of these issues, please don't hesitate to call us.

Sincerely,

Mark S. Dodson
Chief Executive Officer

Gregg S. Kantor
President and Chief Operating Officer

UP CLOSE

AN IN-DEPTH LOOK AT STRATEGIC ISSUES

Energy: A rapidly changing picture

For nearly 150 years, NW Natural has been serving the energy needs of Northwest communities. We know our customers expect us to provide safe, reliable service and keep their energy costs as low as possible – and we're proud of our track record.

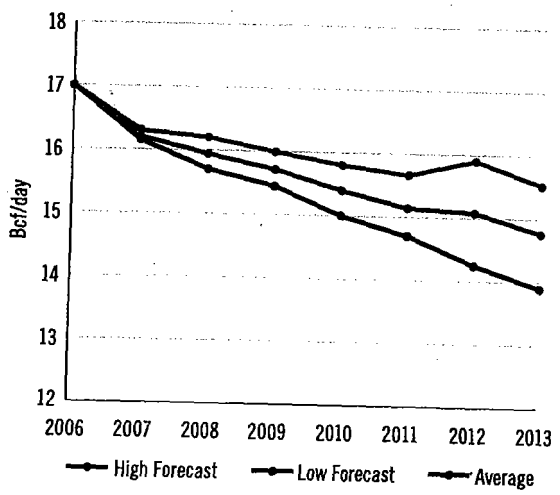
But changes to the energy picture are creating new challenges. And we think it's our responsibility to describe what we see ahead, the choices our region must make – and the impact on all of us.

Strained supplies, rising demand

Oregon imports nearly 100 percent of its gas supplies – with two-thirds coming from Canada, and one-third from the Rocky Mountains. But today we face new challenges:

- Canadian supply is expected to decline by as much as 14 percent by 2013. Its production wells aren't producing as much gas as in the past. At the same time, Canada is using more of the natural gas it produces to extract oil from tar sands, so it's exporting less to the U.S.

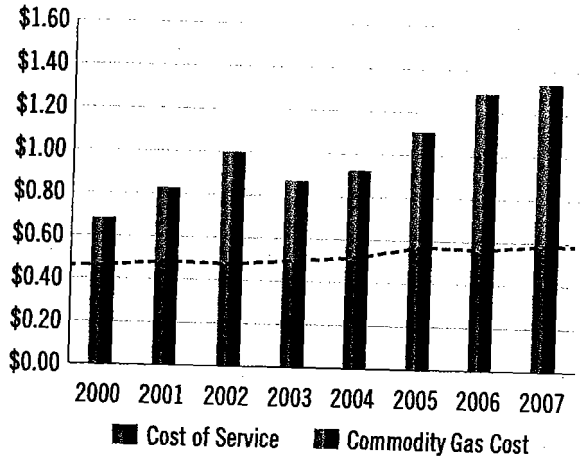
WESTERN CANADIAN SEDIMENTARY BASIN DECLINING PRODUCTION FORECAST



Source: NWGA Gas Outlook 2007

STRAINED SUPPLIES + HIGH DEMAND = HIGHER PRICES

RESIDENTIAL BILLING RATE - OREGON
Annual Cost Per Therm



While NW Natural's costs to serve customers have remained relatively flat, gas commodity prices have tripled in just the last seven years. A tighter balance between supply and demand has put an upward pressure on prices. This is primarily due to higher demand for natural gas to produce electricity.

- Rocky Mountain gas supplies are actually increasing, but pipelines connecting to Rocky Mountain supply basins are now sending more gas to the East. So gas customers in the West now have to compete for supplies that once primarily served Western states.

"A shortage of natural gas anywhere in the country, and especially in the Western U.S. and Canada, will affect gas availability and cost in Oregon ... Both adequate supplies and adequate pipeline capacity are necessary to ensure natural gas is available at reasonable prices in Oregon."

Northwest Power and Conservation Council, Letter to Congressman Wu, Dec. 2007

Carbon constraints will mean even more demand for natural gas

There is widespread consensus that climate change is real and we must act now to address it. Congress is expected to establish greenhouse gas reduction requirements in the near future, and some states like Oregon, Washington and California already have reduction goals in place. That means America's electric providers are going to have to find a new way to meet growing demand without using coal – which currently provides about half of the nation's electric power.

The Energy Information Administration forecasts that even with higher prices total U.S. electricity consumption will increase 43 percent by 2030.

What does this mean for the Northwest?

Today, 40 percent of Oregon's electricity is generated from coal, and a good portion of the rest comes from hydropower. In a perfect world, we would meet our region's growing energy demands by consuming less, using only the highest-efficiency equipment, and completely relying on renewable resources. In the real world, we have to make tougher decisions.

- **Renewables.** Today renewables generate about 4 percent of Oregon's electricity (equal to about 14 days' worth of power over a year). Oregon has set a goal of having 25 percent of its power generated by renewables by 2025. Washington's goal is to reach 15 percent by 2020. But what will fill the gap until - and after - we meet our renewable goals? And what will provide the backup energy needed for intermittent renewables when the sun isn't shining or the wind doesn't blow?

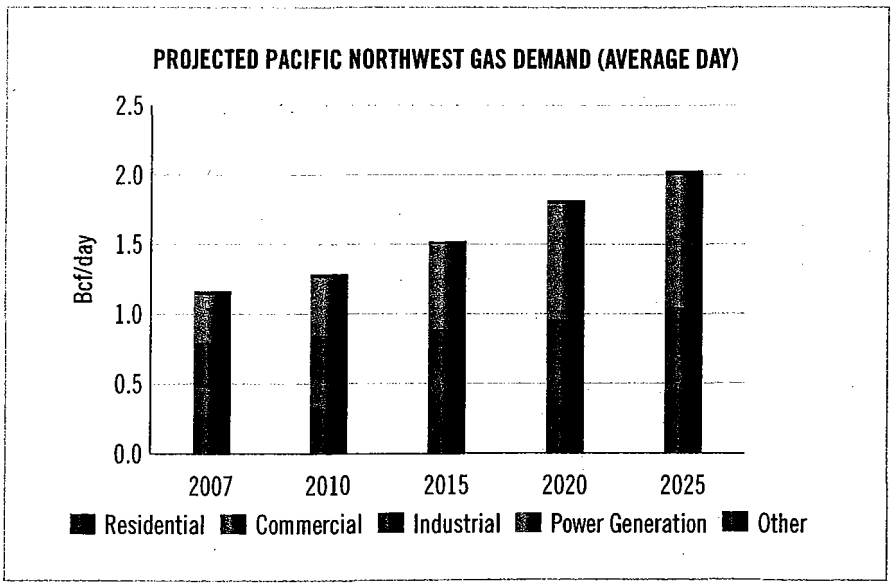
The answer: natural gas. Here's why:

- **Hydropower.** Concerns about fish make it unlikely that new hydro facilities will be built. In fact, there continues to be pressure to limit operations or take some existing facilities out of service due to salmon issues.
- **Nuclear.** Politically, nuclear energy is not a feasible option in the Pacific Northwest. And even if there was public support for nuclear, it would take 10 to 15 years to site and build.
- **Clean coal.** Clean coal is a term that covers a variety of carbon-sequestration technologies that are many years away from being practical alternatives, according to industry and government experts.
- **Natural gas.** Natural gas emits less than half the greenhouse gas emissions of coal and does not contain the other toxins and air pollutants coal produces.

Natural gas is unequivocally the cleanest option available to complement renewables and reliably meet our growing energy demands.

While NW Natural does not sell gas for electric generation, we recognize that in the decades to come Oregon is going to need a lot of it to transition from coal. In fact, regional demand for natural gas is projected to increase by more than 50 percent by 2025.

In a recent report, the U.S. Department of Energy concluded that with aggressive development of transmission lines, wind energy could provide 20 percent of the nation's electricity by 2030.

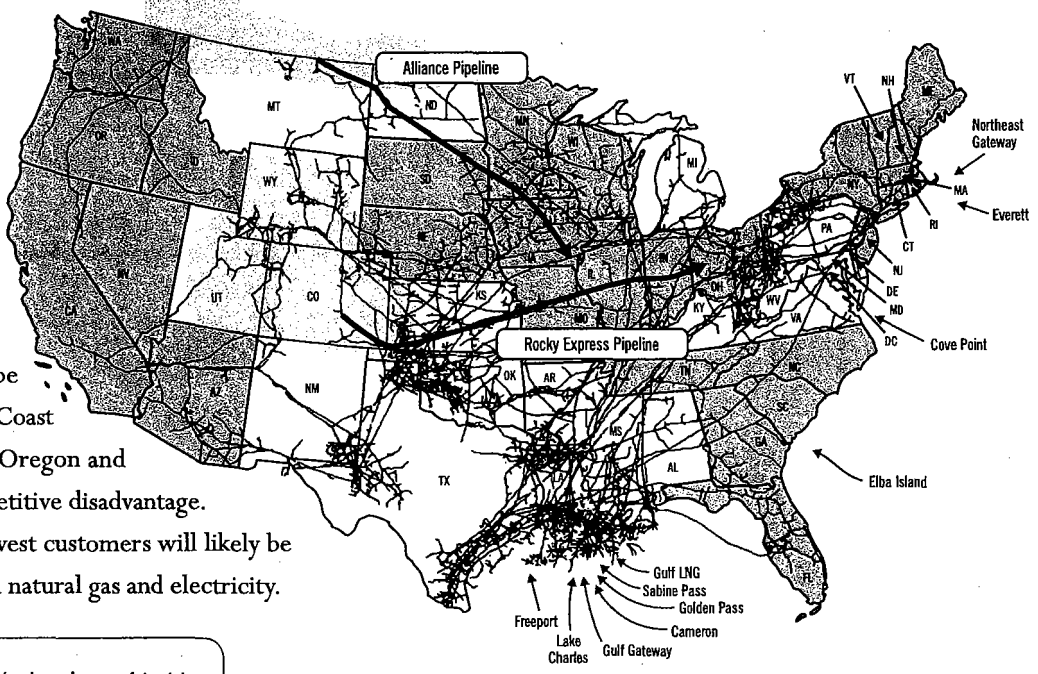


Source: ICF International Report for WA State, Nov. 2007

A 2007 ICF International report produced for the State of Washington projected that demand for natural gas will increase significantly in the Pacific Northwest by 2025 – largely due to increased use of gas for electric generation.

Is the West ready for the rush to gas?

Most states have anticipated the growing need for natural gas and the inevitable competition for lower cost supplies – and have acted. Pipelines now move more of the Rocky Mountain gas we use in the Northwest to the Midwest and East Coast. By next year, 11 liquefied natural gas terminals will be fully operational in the East and Gulf Coast states. Without new infrastructure, Oregon and Washington will be at a severe competitive disadvantage. Gas will be available, but our Northwest customers will likely be paying much higher prices – for both natural gas and electricity.



- Interstate pipelines
- Current LNG terminals
- LNG online in 2008/2009
- Pipelines now taking gas east
- 80%+ dependency on interstate pipeline network for natural gas
- Western Canadian Sedimentary Basin and Rocky Mountain Basin

Map sources: EIA and FERC, Jan. 2008

Where do we go from here?

While there are significant challenges ahead, there are steps we can take to combat climate change and reduce the impact of higher energy costs.

Here's how we can move forward:

- **Support energy efficiency.** It's the fastest and least costly way to reduce our impact. We can do much more through enhanced building codes and by promoting higher-efficiency equipment.
- **Develop new energy resources, including renewables.** We need public incentives and private investment to make renewable resources available and affordable, and to pursue advancements in clean coal technologies.
- **Use gas directly, where possible.** Direct use of natural gas – that is, using gas for space and water heating, rather than burning it to create electricity – makes a lot of sense. By using gas directly you get almost twice as much energy value, so you use less gas and create fewer emissions. You also reduce demand for electricity, which can cut emissions substantially where coal is the major generation source.
- **Pursue access to LNG.** Liquefied natural gas has the same composition as the natural gas we use today that we get from domestic sources. When super-chilled to extremely low temperatures it becomes liquid, making it possible to ship or store in tanks. LNG is used commonly in many parts of the world, including in our Gulf and East Coast states.
- **Develop new pipelines.** The Northwest will need new pipelines – either in conjunction with LNG or independent of imported gas supplies.

Although three LNG terminals and four pipelines have been proposed for Oregon, no more than one terminal and one pipeline of the seven projects will likely be built. Investors have no incentive to build more capacity than Western markets can use.

Myths about LNG

NW Natural is not a partner in any of the proposed liquefied natural gas facilities. But we do support the development of new gas supply options in Oregon and we strongly believe access to LNG will help hold prices down.

The following are answers to some concerns that have been raised about LNG.

Would LNG contribute to the greenhouse gas problem?

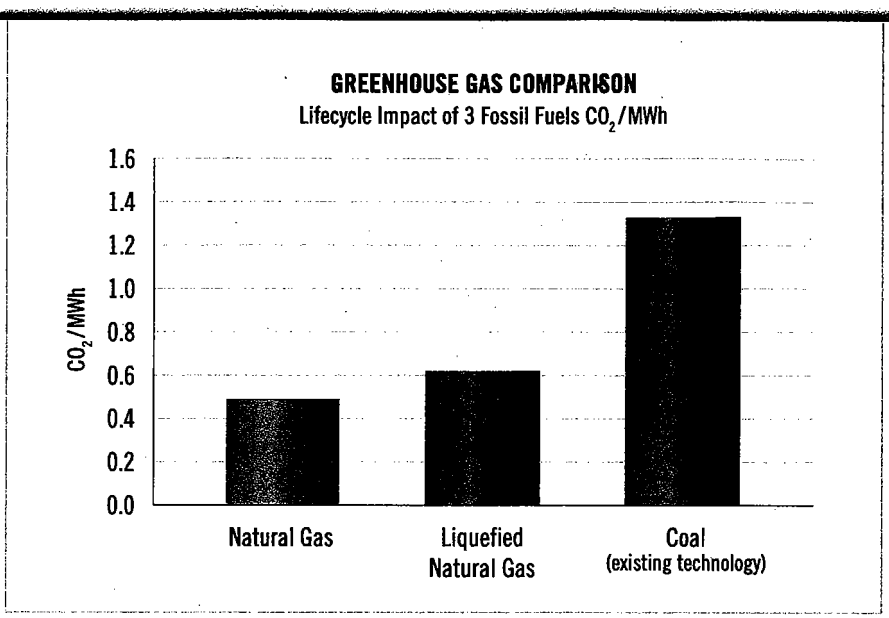
Some LNG opponents have asserted that the process of liquefying, transporting and turning it back into gas uses a lot of energy – and creates as much CO_2 as coal.

However, recent analysis conducted by Pace Global Energy Services found that LNG processing, transportation and use emits about half the greenhouse gas emissions of the full life cycle of coal. Coal also produces other pollutants not found in gas.

LNG in Oregon: California's gas tank?

Some Oregon residents fear that LNG imported through Oregon is destined for California and won't benefit the Pacific Northwest.

In fact, NW Natural is looking at LNG as an important new gas source for its customers. Other Oregon gas utilities, industrial gas users and electric utilities would also want first access to LNG. These new supplies would help reduce price pressures on natural gas and keep the commodity more affordable for NW Natural customers and other Pacific Northwest gas utilities.



Source: Pace Global Energy Services, May 2007

While the energy required to chill, transport and vaporize LNG adds to its carbon footprint, liquefied natural gas is still considerably lower in greenhouse gas emissions than coal – especially when you include the energy it takes to mine and transport coal.

- **Closer is better.** The shorter the distance gas travels through a pipeline, the lower the costs to customers.

> "If an LNG terminal is built in Oregon, it is likely to benefit the entire Western market, but may be especially beneficial to Oregon because proximity to the supply source is typically an advantage."
>
> *– Northwest Power and Conservation Council, Letter to Congressman Wu, Dec. 2007*

- **Some gas probably will go to California.** At some times of the year, an LNG terminal may bring in more gas than Oregon can use. That gas will likely be available for customers in California and other Western states.

That's the way the energy system works. For example, in most years, Oregonians benefit from California-generated electricity in the winter, and we send surplus hydropower to California in the summer.

- **We're dependent on other states for much of our energy.** Oregon imports virtually 100 percent of its natural gas supplies. We have it shipped to us from pipelines that cross Colorado, Utah, Wyoming, Idaho and Washington. Electric power is also shared among West Coast states. If other states chose to be energy isolationists, Oregon would be in big trouble.

- **Other benefits: jobs and tax revenues.** Private investment will finance any new LNG terminal or new pipelines. There are no public subsidies for this kind of infrastructure. On the other hand, communities and the state will benefit from:
  - Construction and operating jobs;
  - Local property taxes;
  - State corporate income taxes; and
  - Competitive energy prices.

It's important to note that NW Natural's customers are not financing the development of this new infrastructure. Projects like Palomar Pipeline (see page 6) are financed by NW Natural shareholders and investors in other companies.

(continues on page 5)

"As we look to future resource needs in the region, it is quite evident by all forecasts that natural gas will play an increasing role in the production of electricity for Northwest consumers. An adequate supply of natural gas is an essential component of our resource infrastructure and, in essence, may be needed to help meet our state's renewable portfolio standards ... Liquefied natural gas terminals could offer an additional source and thus provide supply diversity and reliability."

– Pacific Northwest Utilities Conference Committee, a coalition of public and private electric utilities, Letter to Governor Kulongoski, March 2008

Isn't LNG a step backward – away from renewables?

Renewable energy sources are critical to America's ability to reduce greenhouse gas emissions. But they're not the whole solution. We have to pursue both renewable resources and additional natural gas supplies.

- **Meeting demand.** There are simply not enough renewable resources to meet all our energy needs. Oregon is a leader in renewable development – and we still only have enough to provide about 14 days' worth of power each year.
- **Renewables require backup.** Wind power is great – but it's not always available. A 2007 ICF International study concludes that more than half the new electric generating capacity built in our region between now and 2025 will be renewable. However, because resources like solar and wind can only produce energy about 30 percent of the time, the Northwest will still rely on conventional electric generation most of the time. That means gas-fueled backup systems.
- **Natural gas investments won't conflict with renewable development.** We can and must pursue both paths to new energy supplies. Investors are prepared to develop LNG facilities, natural gas pipelines and storage without public funding. With public and private incentives to develop renewables, there will be enough money to fund both gas and renewable projects.

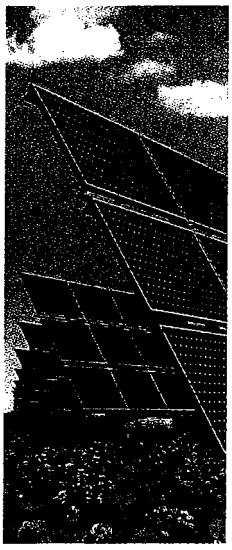
Is LNG safe enough to have in Oregon?

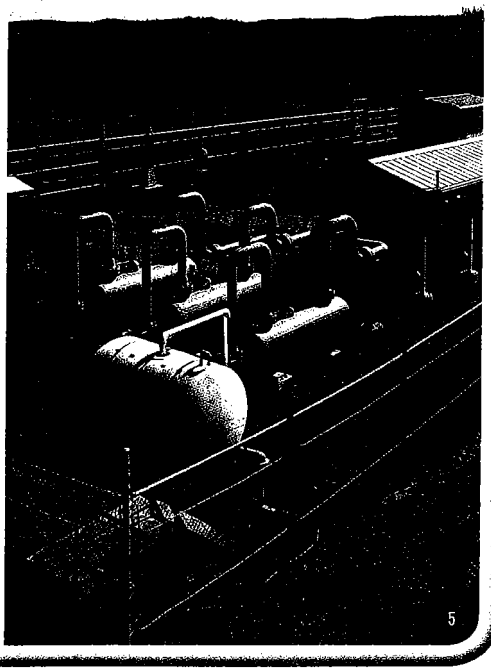
LNG has an excellent safety record. For over 60 years, there has not been an accident involving liquefied natural gas that has affected a member of the general public. Liquefied natural gas cannot explode or burn because it contains no oxygen to react with the fuel, nor is it under pressure when it is transported or stored.

Here in Oregon, NW Natural has operated two LNG storage facilities safely for more than 40 years. Four U.S. terminals have operated safely for more than 30 years.

"In a twist, the effort to build alternative-energy projects like solar arrays and wind farms also boosts construction of gas-fired plants. Because wind is unpredictable, it's often necessary to build backup generators, and gas-fired plants have the advantage in that they can be started up relatively quickly ... In addition, regulatory approval and construction times are shorter for gas plants than coal or nuclear."

– Wall Street Journal, April 18, 2008





NW Natural: planning for the region's energy needs

- **Palomar.** NW Natural plans to build a new pipeline that will connect its distribution system to an interstate pipeline. Construction of this new pipeline, called Palomar, is a long-standing goal of NW Natural's. The company views it as essential for ensuring gas supply reliability for its customers.

  Currently, about 99 percent of NW Natural's gas comes through one pipeline system. Palomar would add a new link, offering the company more flexibility in purchasing supplies and more backup in case of pipeline interruptions. Palomar would connect NW Natural's system near Molalla to the TransCanada system in Eastern Oregon.

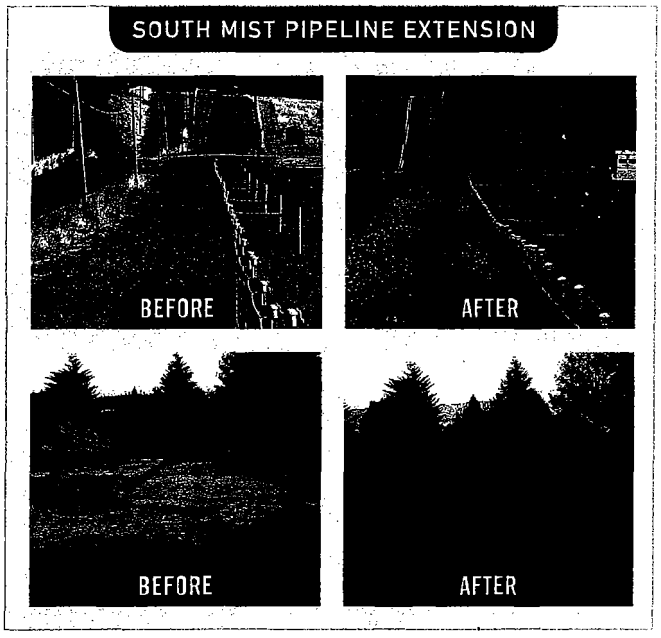
  Palomar also could be an important link for either new LNG or new Rocky Mountain supplies. Palomar is being designed so that it can be extended to one of the proposed LNG terminals on the Columbia, should one be built. It also could be available to link the Willamette Valley to new gas sources from the Rockies if one of the new pipeline proposals pans out.

- **Storage.** One of the most effective ways to protect gas consumers against fluctuating gas prices is through storage. Storage helps companies like NW Natural manage gas costs by allowing us to buy and store gas when prices are lowest, and by reducing our gas transportation costs during peak seasons.

  With greater dependence on natural gas – and more volatility expected in gas prices – NW Natural predicts a need for more storage in the Western states. That's why the company has been expanding its Mist underground storage facilities and why it is developing Gill Ranch Storage in Central California.

NW Natural: building pipelines responsibly

NW Natural has an excellent track record of building and operating more than 14,000 miles of pipelines across our service territory safely and with care for our environment.



To ensure the safety of its pipelines, NW Natural:

- Always builds to or beyond safety regulations.
- Carefully monitors our transmission pipelines using sophisticated technology.
- Executes an aggressive inspection program in compliance with strict federal standards.

Protecting farmland and our environment is vital to all of us:

- Farmers can continue to plant almost all crops over pipelines.
- Organic farms can continue to operate with pipelines on the property.
- Farms continue operation and land is restored within months of construction.
- Only a narrow path of forest land is impacted (20 ft. either side).
- Farmers are fairly compensated for any land impacted during or after construction.
- New technologies allow construction that drills under rivers, streams and wetlands to avoid interfering with fish and wildlife habitat.

American Gas Association

NRDC
The Earth's Best Defense

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For Release:
May 22, 2008
PR –18

Combating Global Warming with Increased Energy Efficiency is a Win-Win says AGA, NRDC

Washington, D.C. – The American Gas Association (AGA) and the Natural Resources Defense Council (NRDC) joined forces today to highlight the importance of energy efficiency in combating global warming. AGA and NRDC issued a joint statement calling for coordinated incentives, government standards and regulatory reforms that would increase energy efficiency and reduce greenhouse gas emissions nationwide.

"By using a clean fuel, and using it efficiently, America's natural gas utilities and their customers are leading the way in the fight against global warming," said Laurence Downes, Chairman and Chief Executive Officer of New Jersey Resources. "Today, the AGA and the NRDC are renewing their call to public utility commissions to consider the merits of decoupling and to adopt decoupling proposals that will create incentives for natural gas utilities to aggressively promote efficiency and conservation."

"Energy efficiency provides a clear path forward as consumers pay higher and higher energy bills and are facing difficult choices between food, gas for their car, or heating and cooling their homes," said Ralph Cavanagh, Co-Director of NRDC's Energy Program. " We and the nation's hometown natural gas utilities are united in a determination to get more work out of less energy, and to create performance-based incentives that not only encourage utilities to reward customers to be more efficient but also have the added benefit of reducing global warming pollution. Making energy efficiency financially attractive for utilities and customers alike is the best way to cut energy bills and curb global warming, at a time when definitive action is needed for both."

AGA and NRDC have been working together to highlight the importance of energy efficiency since 2004. That summer, the organizations issued a joint statement encouraging state public utility commissions to consider innovative proposals promoting energy efficiency and conservation in a manner that would benefit both customers and shareholders.

The original AGA/NRDC proposal was called "revenue decoupling" and was designed to break the link between utilities' earnings and their customers' energy consumption. In 2004, few states had adopted revenue decoupling. Today, 26 natural gas distribution utilities in 13 states have implemented revenue decoupling programs that serve 20

million residential customers. From Oregon to New Jersey, consumers are benefitting from expanded energy efficiency investments made by their utilities.

The new statement maintains support for revenue decoupling, but goes one step further with advocacy for performance-based mechanisms which provide economic incentives for utilities to promote energy efficiency. Additionally, the statement puts new emphasis on joint support for efficiency standards and tax incentives at the state and national level. The goal is to accelerate improvements in every sector of the economy, including contributions to the enactment of cost-effective efficiency standards and tax incentives, along with consumer education and marketing programs designed to increase home energy efficiency and reduce consumption. The concept of earnings opportunities linked to energy efficiency is at an early stage; however the end result should be a win-win solution for natural gas utilities and their customers.

Among fossil fuels, natural gas has the fewest greenhouse gas emissions. Natural gas homes and appliances are increasingly efficient and produce fewer emissions. The average household today uses 32 percent less natural gas than it did in 1980.

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American Gas Association

NRDC
THE EARTH'S BEST DEFENSE

Second Joint Statement of the American Gas Association and the Natural Resources Defense Council

May 2008

As the United States confronts the dual challenges of ensuring that Americans have access to affordable, environmentally clean and reliable energy services, while addressing global climate change, the American Gas Association (AGA) and the Natural Resources Defense Council (NRDC) have been working together to accelerate progress toward a clean, energy efficient future. In 2004, AGA and the NRDC issued a joint statement that identified significant regulatory barriers to achieving energy efficiency. AGA and the NRDC encouraged state public utility commissions to consider innovative proposals to promote energy efficiency and conservation in a manner that would benefit both customers and shareholders. The National Association of Regulatory Utility Commissioners encouraged state officials to consider the joint AGA-NRDC recommendations,[1] and the states' initial response has been encouraging.

Today, AGA and the NRDC issue a second joint statement recommending the next steps toward win-win solutions for American consumers and the natural gas utilities that serve them. As we did in 2004, AGA and the NRDC urge state public utility commissions and officials responsible for publicly-owned natural gas distribution systems to consider proposals for implementing cost-effective programs that will increase energy efficiency and reduce the nation's carbon footprint while also balancing shareholder interests.

1. **Removing Disincentives for Utilities to Promote Energy Efficiency and Reduce Greenhouse Gas Emissions, and Uniting to Achieve Increased Savings Through Programs and Standards.**

It is now almost universally recognized that energy efficiency is a large, underutilized, resource that needs to be expanded significantly to reduce consumer costs, improve energy security and reduce greenhouse gas emissions.[2] Numerous studies and extensive experience in many states and countries have shown that improving energy

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[1] *Resolution on Gas and Electric Energy Efficiency*, sponsored by the NARUC Natural Gas Task Force, Committee on Gas, Committee on Consumer Affairs, Committee on Electricity, and Committee on Energy Resources and the Environment. Adopted by the NARUC Board of Directors, July 14, 2004.

[2] *See, e.g., National Action Plan for Energy Efficiency Vision for 2025: Developing a Framework for Change* (November 2007). http://www.epa.gov/cleanenergy/documents/vision.pdf.

efficiency can be critical to meeting these goals cost-effectively.[3] Consumer surveys show strong support for coordinated government and utility efforts to increase conservation and energy efficiency.[4]

Yet there are a number of barriers blocking the path forward to increased energy efficiency. One significant barrier has been regulatory policies that unintentionally but effectively discourage gas distribution companies from promoting energy efficiency improvements. AGA and the NRDC pointed this out in our July 2004 joint statement:

> When customers use less natural gas, utility profitability almost always suffers, because recovery of fixed costs is reduced in proportion to the reduction of sales. Thus, conservation may prevent the utility from recovering its authorized fixed costs and earning its state-allowed rate of return. In this important aspect, traditional rate practices fail to align the interests of utility shareholders with those of utility customers and society as a whole. This need not be the case.[5]

Since the joint statement was issued in 2004, a significant number of gas distribution utilities have been given permission to adopt ratemaking mechanisms that better align the interests of utility shareholders, their customers and society as a whole. Today 26 natural gas distribution utilities in 13 states have implemented revenue decoupling programs that serve 20 million residential customers. The National Action Plan for Energy Efficiency, which was developed by more than 50 diverse stakeholder groups, included as one of its five recommendations the need to "[m]odify policies to align utility incentives with the delivery of cost-effective energy efficiency and modify ratemaking practices to promote energy efficiency investments."[6] Additionally, Congress passed the Energy Independence and Security Act of 2007, directing each state regulatory authority to consider "separating fixed-cost revenue recovery from the volume of transportation or sales service provided to the customer."[7] Today, AGA and the NRDC again urge state public utility commissions and officials responsible for publicly-owned natural gas distribution systems to actively support natural gas utilities' energy efficiency proposals that use automatic rate true-ups to ensure a utility's opportunity to recover its authorized fixed costs. We also urge state public utility commissions that have adopted such programs on a trial basis to make longer term commitments. Finally, we will assign high priority to mutual advocacy for improved energy efficiency standards at both state

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[3] *See, e.g., Impacts of Energy Efficiency and Renewable Energy on Natural Gas Markets in the Pacific West*, William Prindle, R. Neal Elliott, Ph.D., P.E., Anna Monis Shipley, American Council for an Energy-Efficient Economy, Report Number E062 (January 2006).

[4] *See, e.g.,* M. Kubik, *Consumer Views on Transportation and Energy* (Third Edition), National Renewable Energy Laboratory Technical Report, NREL/TP-620-39047 (Jan. 2006), http://www.osti.gov/bridge.

[5] Joint Statement of the American Gas Association and the Natural Resources Defense Council (July 2004) at 2.

[6] *National Action Plan for Energy Efficiency – A Plan Developed by More Than 50 Leading Organizations in Pursuit of Energy Savings and Environmental Benefits Through Electric and Natural Gas Energy Efficiency* (July 2006) at 2, 7, 8, and 1-10. See also *Aligning Utility Incentives with Investment in Energy Efficiency – A Resource of the National Action Plan for Energy Efficiency* (Nov. 2007) http://www.epa.gov/cleanenergy/documents/incentives.pdf.

[7] *See* Sec. 532(b)(6), *Energy Independence and Security Act of 2007*, P.L. 110-140, Dec. 19, 2007 (In general, "[t]he rates allowed to be charged by a natural gas utility shall align utility incentives with the deployment of cost-effective energy efficiency." "[E]ach State regulatory authority and each non-regulated utility shall consider- (i) separating fixed cost revenue recovery from the volume of transportation or sales service provided to the customer; (ii) providing to utilities incentives for the successful management of energy efficiency programs, such as allowing utilities to retain a portion of the cost-reducing benefits accruing from the programs;").

and federal levels, and we will seek urgently needed extensions for federal tax incentives for energy efficiency in buildings and equipment. We will work to ensure that these standards and incentives are designed in ways that avoid inappropriately influencing customers' fuel choices, from both economic and environmental perspectives.

2. Developing Performance-Based Incentives for Utilities to Promote Energy Efficiency and Reduced Greenhouse Gas Emissions

Simply removing utility disincentives to promote energy efficiency may be adequate if the goal is to achieve relatively modest increases in efficiency. But neutrality is no substitute for committed action. If energy efficiency achievements are to reach the level required by the various climate change bills currently being considered by Congress and under review or adoption in states across the country, then utility commissions need to consider linking such achievements to earnings opportunities for the utilities involved.[8] We agree that such opportunities would yield significant increases in energy efficiency and reductions in customer energy consumption. Despite decades of programs designed to promote energy efficiency, it is widely recognized that these programs remain critically underutilized in the nation's energy portfolio.[9] Without carefully considered incentive programs, it seems unlikely that dramatically improved results will occur in the future.

The National Action Plan for Energy Efficiency discusses three different types of utility performance incentive mechanisms: 1) performance target savings, 2) shared savings incentives, and 3) rate of return incentives.[10] Performance target and shared savings mechanisms have been adopted in a number of states, and while differing in structure and operation, typically seek to allow utilities operating at or above a prescribed minimum performance level to capture some portion of net benefits delivered (usually based on energy savings performance).[11] Rate of return incentives might offer a utility an increased return for energy efficiency investments and/or an even higher return on total equity investment for superior performance.[12] While each option has its

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[8] Congress recently encouraged state commissions and unregulated utilities to consider such utility energy efficiency earnings opportunities. *See* Sec. 532(b)(6)(B)(ii), *Energy Independence and Security Act of 2007*, P.L. 110-140, Dec. 19, 2007 ("[E]ach State regulatory authority and each nonregulated utility shall consider- (ii) providing to utilities incentives for the successful management of energy efficiency programs, such as allowing utilities to retain a portion of the cost-reducing benefits accruing from the programs;").

[9] *See, e.g., Aligning Utility Incentives with Investment in Energy Efficiency* at ES-1. For years, groups such as the American Council for an Energy Efficient Economy (ACEEE) have produced numerous studies detailing the dramatic results possible if various energy efficiency measures were adopted. *See, e.g., Examining the Potential for Energy Efficiency to Help Address the Natural Gas Crisis in the Midwest,* Martin Kushler, Dan York, and Patti Witte (Jan. 2005, ACEEE Report No. U051) (projecting annual Midwest customer cost savings of $2 billion on their natural gas bills by 2010); *Potential for Energy Efficiency and Renewable Energy to Meet Florida's Growing Energy Demands*, R. Neal Elliott, Maggie Eldridge, Anna M. Shipley, John "Skip" Laitner, Steven Nadel, Philip Fairey, Robin Vieira, Jeff Sonne, Alison Silverstein, Bruce Hedman and Ken Darrow (June 2007, ACEEE Report No. E072); *Impacts of Energy Efficiency and Renewable Energy on Natural Gas Markets in the Pacific West*, William Prindle, R. Neal Elliott, Anna Monis Shipley (Jan. 2006, ACEEE Report No. E062) (projecting reduced natural gas bills and reduced natural gas consumption if energy efficiency measures were adopted).

[10] *Aligning Utility Incentives with Investment in Energy Efficiency: A Resource of the National Action Plan for Energy Efficiency* (Nov. 2007) at 6-1 (chapter on performance incentives).

[11] *Id.* at 6-3 and 6-4.

[12] *Id.* at 6-11.

advantages and disadvantages, we unite in supporting approaches that link energy-efficiency incentives to independently verified net benefits that utilities deliver to customers through either successful administration of cost-effective efficiency programs and other authorized efficiency programs that serve low-income constituencies, or contributions to enactment of cost-effective efficiency standards and tax incentives.[13] AGA and the NRDC encourage state commissions and officials responsible for publicly-owned natural gas distribution systems to adopt energy efficiency incentive mechanisms for natural gas utilities that will reduce consumer costs, reduce greenhouse emissions and align with shareholders' interests.

3. Recognizing the Potential Contributions of Efficient Natural Gas Use in Promoting Reduced Greenhouse Gas Emissions

Among fossil fuels, natural gas applications lead the way in reducing greenhouse gas emissions.[14] Average residential and commercial natural gas consumption is much lower today than in the 1970s, due to improved energy efficiency and conservation. The 64 million households served by natural gas today heat their homes and their water, feed their families and dry their clothing using 1/3 less energy than they did in 1980.

Our paramount joint objective is developing ways to help America extract more economic benefits from the most efficient use of natural gas.[15] There should be continued focus on the environmental benefits of more efficient direct use of natural gas in homes and businesses, which can and should be an important strategy to lower U.S. greenhouse gas emissions.

AGA and the NRDC pledge to continue their efforts to find more ways to use natural gas efficiently, thereby assisting consumers and speeding the transition to a lower carbon future.

This Joint Statement also has been reviewed and endorsed by:

Alliance to Save Energy

ALLIANCE TO
SAVE ENERGY
Creating an Energy-Efficient World

[13] Energy efficient incentives do not include rate design mechanisms, such as margin decoupling, which merely reduce utility disincentives. We also agree that consumer education and marketing expenditures are important to the success of many of the energy efficiency programs that this statement references and supports.

[14] When burned in power plants of equivalent thermal efficiency, natural gas emits 45 percent less CO_2 than coal and 30 percent less CO_2 than oil on an energy equivalent basis. This advantage can be further increased by integrating combined heat and power applications with end use efficiency improvements.

[15] Along with natural gas, some natural gas utilities have supplemented their supply needs with renewable sources of supply such as biogas, which can help reduce greenhouse gas emissions.