

STATEMENT OF ISSUES SUMMARY
Conservation Incentive Rulemaking – Docket U-100522

Commission Inquiry

The inquiry will focus on the need for rules, both substantive and procedural, addressing the issue of lost revenue due to conservation for both gas and electric utilities.

The Commission will examine, with the participation and assistance of the utilities, representatives of ratepayers, and other stakeholders, the following topics, among others:

- The various mechanisms available for addressing declines in revenues due to conservation and the pros and cons of each;
- The various mechanisms for providing an incentive for utility-sponsored conservation programs and the pros and cons of each;
- How such mechanisms may affect the conservation achieved by the various utility programs;
- How the conservation achieved can best be evaluated, measured, and verified;
- The impact of lost revenue recovery mechanisms and conservation incentives on utility rates; and
- The need for rules or other statements of policy given existing requirements in law, rule, and Commission practice for utilities to achieve conservation.

| Party | STATEMENT OF ISSUES |
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| Puget Sound Energy | <ol style="list-style-type: none"> 1. Is it in customers' interest to remove the financial motivation for utilities to sell as much energy as possible so that barriers to maximum conservation savings are removed and customer bills are aligned with allowed utility costs? 2. How should regulatory mechanisms consider the distribution of all the benefits from conservation. 3. What are the major components necessary for determining a utility's unrecovered fixed costs due to conservation? 4. Should a general methodology for calculating unrecovered fixed costs due to conservation be established? |

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| Avista Utilities | <ol style="list-style-type: none"> 1. The definition of lost margins and “found” margins related to energy efficiency, and how to measure them. 2. Identification of the specific disincentives to investment in energy efficiency. 3. Clarity of the difference between <u>mechanisms to recover costs</u>, including lost margins, associated with energy efficiency, and <u>incentive mechanisms</u>. 4. Alignment of ratemaking practices with the requirements of the Energy Independence Act (I-937). 5. The distinction between cost recovery for all prudently incurred costs related to energy efficiency, versus cost recovery contingent upon achieving certain levels of energy efficiency, e.g., recovery of prudently incurred costs, including, lost margins, should not be conditioned upon achieving a certain level of energy efficiency. 6. A “level playing field” for investment in efficiency, as compared to investments in other utility plant and equipment, e.g., the attractiveness of the investment in energy efficiency for the Company and its investors should be comparable to that of investments in other utility facilities. 7. Lost margin recovery for energy efficiency savings in the Company’s service area related to regional energy efficiency efforts and other programs to raise customer awareness of energy efficiency supported by the Company, in addition to lost margin recovery for specific programmatic measure directly funded through incentives to customers. 8. Processes, timelines and administrative efficiency for various cost recovery and incentive mechanisms. 9. To the extent that energy efficiency expenditure vary from tariff rider collections, should the utility be allowed to accrue interest on any such differences. |

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| PacifiCorp | <ol style="list-style-type: none"> 1. The relationship between conservation incentives and conservation targets established under I-937. 2. The different impacts conservation has on electric and gas utility operations and how to set appropriate incentives for each. 3. What are the implications of using historical test year loads in rate cases to set future rates? 4. What are the ramifications of fixed utility costs being recovered through volumetric energy charges? How can a proper balance be struck? |
| Cascade Natural Gas Corp. | <ol style="list-style-type: none"> 1. What are the impacts of caps and limitations on recovery mechanisms and at what point do such limitations mitigate a utility's incentive to promote conservation. 2. Should mechanism standards and guidelines apply universally to all Washington utilities or should they be adaptable to individual utility needs retaining best practices from mechanisms already in existence? 3. Should recovery mechanisms include rate adjustments on an individual customer basis based on customer usage history or based on the entire customer class? 4. Should the WUTC consider system limitations associated with certain decoupling programs when developing new regulation and standards. |

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| Northwest Natural | <p>The Company identifies the following issues other than conservation that it believes should be considered:</p> <ol style="list-style-type: none"> 1. <u>Weather</u> – Customers use less gas when weather is unseasonably warm. Conversely, a utility collects more revenue when weather is unusually cold and customers are using more gas to heat their homes. 2. <u>Elasticity</u> – Customers use less as gas prices increase. 3. <u>General trend of reduced natural gas usage</u> – The AGA reports, “Natural Gas use per customer has decreased by about 1 percent per year for the last 38 years, which means that the average residential customer today uses 39 percent less than they did 38 years ago.”¹ This trend, which is not clearly attributable to any one reason identified above, requires regulatory consideration. |
| Public Counsel | <p><u>Need for Incentives</u></p> <ol style="list-style-type: none"> 1. Are additional incentive or decoupling/lost margin mechanisms necessary, given that: <ul style="list-style-type: none"> • Regulated utilities are required by law to acquire “least cost” resources and to pursue all achievable cost-effective conservation or be subject to financial penalties? • Acquisition of “least cost” resources is by definition economically advantageous and prudent for a regulated utility. • Washington regulated utilities have established and pursued successful conservation programs without the existence of incentive programs or decoupling. • Although per-customer usage has seen some declines due to conservation, the economy, and other factors, total company sales and revenues are not declining and are flat or increasing due to load growth. |

¹ See <http://www.aga.org/Legislative/RatesRegulatoryIssues/ratesregpolicy/Issues/energyefficiency/NaturalGasUtilitiesandTheirCustomers.htm>

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| Public Counsel <i>(Continued)</i> | <p><u>Mechanism Characteristics</u></p> <ol style="list-style-type: none"> 2. What are the distinctions between incentive mechanisms and anti-disincentive mechanisms (lost margin/decoupling)? 3. In the event such mechanisms are approved for use, should a utility be permitted to recover additional revenues under both an incentive mechanism and a lost margin/decoupling mechanism simultaneously? 4. Are disincentives to pursue conservation created for customers by the adoption of utility incentive programs or lost margin/decoupling mechanisms? 5. What is the precise magnitude of the lost margin problem being experienced by regulated utilities as a result of their own conservation programs? 6. If lost margin can be accurately calculated, should any revenue recovery allowed under an incentive or lost margin/recovery mechanism be limited to the amount of actual lost margins due to the utility’s own programs? (i.e. exclude recovery for general economic factors, exogenous effects not caused by utility programs). 7. Should incentive or lost margin/decoupling mechanisms include an “earnings test” to prevent recovery of excessive amounts from customers with resulting overearning by the utility? 8. Should adoption of an incentive or lost margin/decoupling mechanism require a downward adjustment in the utility company’s return on equity to reflect the reduced risk to the company? 9. How should DSM targets be defined for purposes of an incentive mechanism? 10. Should DSM targets be specifically tied to approved I-937 targets or to some other goal? 11. Should a lost margin/decoupling mechanism include a “DSM test” to be met as a prerequisite to a utility receiving funds from ratepayers under the mechanism? |

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| Public Counsel <i>(Continued)</i> | <p><u>Mechanism Characteristics</u></p> <p>12. In an incentive mechanism, should a utility receive payments only for exceeding an established target or should incentives be paid where the utility only meets the pre-set target?</p> <p>13. Should payment responsibility for incentives or lost margin/decoupling mechanisms be spread over all customer classes?</p> <p>14. Should payments for incentives or lost margin/decoupling be listed separately on customer bills as surcharge with accompanying explanatory notice?</p> <p><u>Evaluation of Savings Claims</u></p> <p>15. How should savings claims made by utilities in connection with incentive or lost margin/decoupling payments be evaluated, measured, and verified?</p> <p>16. Should establishment of an approved EM&V program be a prerequisite to approval of an incentive or lost margin/decoupling mechanism for a utility?</p> <p>17. Should Washington state establish (via UTC rule or legislation) an independent third party entity with oversight of EM&V, with authority to (1) establish EM&V protocols and requirements and (2) conduct actual EM&V of utility savings claims (either directly, or using technical consultants under contract, for example)</p> <p><u>Alternatives to Incentive and Lost Margin/Decoupling Mechanisms</u></p> <p>18. Should Washington establish an Energy Trust of Oregon (ETO) type of entity to deliver energy efficiency programs in the state?</p> |

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| Industrial Customers of Northwest Utilities | <p>The two broad issues the WUTC is considering are: (1) Do utilities have a disincentive in acquiring all cost-effective conservation and, if so, how should it be addressed in a way that is fair to both the utility and its customers; and (2) Even if there is no disincentive, do utilities need an additional financial incentive to acquire cost-effective conservation and, if so, what incentive is fair to both the utilities and customers? The following are additional issues that should be considered in the context of resolving these broader issues:</p> <ol style="list-style-type: none"> 1. Does the I-937 <i>mandate</i> that electric utilities determine and acquire all cost-effective conservation eliminate or override any “disincentive” or need for a further “incentive” since this voter approved initiative does not contain any incentives to compensate the electric utilities for this mandated conservation? 2. Are there unique differences that warrant different treatment between electric and gas utilities? 3. Assuming “lost revenues” are a disincentive that must be addressed, how are “lost revenues” measured? How “big” of an issue is this, and what would be the potential rate impact? <ul style="list-style-type: none"> • Only losses <i>directly</i> as a result of utility programs (not codes and appliance standards) should be measured. • How are such losses objectively measured and verified; also, does conservation in one area stimulate customer behavior that increases usage in another area? • Losses should be adjusted for new customers, for weather, for usage per customer, and other factors (all complicated calculations). • Losses should be deemed zero if actual loads exceed forecast loads. • If an incentive is adopted, it should not be 100% recovery but subject to a percentage sharing with customers. • How do you ensure that load reduction associated with economic or other non-conservation reasons is isolated and not counted as conservation related load reduction? 4. Should any conservation incentive be offset by a reduced ROE since risk is being reduced to utilities and shifted to customers? |

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| Industrial Customers of Northwest Utilities <i>(Continued)</i> | <p>5. Is any incentive necessary or appropriate for achieving conservation up to the electric utility’s I-937 targets since these are already mandated by law? (If the target is a range, to the upper bound of the range?)</p> <p>6. Is an incentive appropriate for electric utilities to achieve conservation in excess of its two-year I-937 targets? (Is this “non-cost effective” conservation or just earlier acquisition of cost-effective conservation within the ten year target? How do we assure that I-937 targets are not underestimating achievable cost-effective conservation?)</p> <p>7. If an incentive is appropriate, how should it be structured and implemented?</p> <p style="padding-left: 40px;">a) Given the recent rash of electric rate increases in a poor economy, can customers afford a rate increase associated with a utility “incentive” at this time?</p> <p style="padding-left: 40px;">b) Does the incentive approach provide a double rate-related hit for customers, in that the customers pay for all costs related to the conservation program and then they also pay to make the utility whole for lost revenue? Is this fair?</p> <p>8. Should large customers (over 1MW) be treated differently than residential/commercial customers with regard to “lost revenues” recovery and/or incentives?</p> <p>9. Are there any factual changes that justify a departure from the Commission’s conclusion that all three (electric) IOUs are meeting or exceeding NPCC targets and that there is no evidence of a “disincentive” for conservation? Is there any evidence that a direct incentive may lead to superior performance?</p> <p>10. How does the conservation “incentive” fit with the regulatory compact? Are we seeking to guarantee a level of profit for the utilities?</p> <p>11. Are there better mechanisms for promoting conservation than utility incentives?</p> <p>12. Should the incentive costs, if adopted, only apply to the generation portion of the utility costs?</p> |

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| Northwest Industrial gas Users | <ol style="list-style-type: none"> 1. Is there any need for the Commission to engage in proposed rulemaking applicable to natural gas utilities addressing the issue of lost revenue due to conservation or conservation incentives given the Commission’s existing authority to implement appropriate decoupling or other incentive structures to advance conservation through appropriate case by case determinations? 2. Should the Commission if it goes forward with any proposed rulemaking applicable to natural gas utilities bifurcate this docket into two separate dockets or processes, one applicable to electric utilities and one applicable to gas utilities, given the significantly different industry structures between natural gas and electricity (the natural gas commodity is unbundled), greenhouse gas considerations, and differing legal considerations (e.g., I-937 applies only to electric utilities)? 3. Is this docket premature for natural gas given that neither the Commission nor the parties has yet had the benefit of the study of the Cascade Natural Gas Company three-year pilot approved in Docket UG-060256? This pilot is still underway, having started in the fall of 2007 with a study due later this year. 4. In addition to consideration of appropriately structured natural gas decoupling tracking mechanisms, lost margin recovery or incentive payments in conservation program surcharges, should the Commission consider straight fixed variable or modified fixed variable natural gas rate design in this inquiry for natural gas sales customers (i.e., the increased full or partial recovery of a natural gas utility’s costs in its fixed charges for its sales customers), or are those issues better and more appropriately addressed in the context of each individual natural gas general rate case proceeding? 5. How do the various mechanisms for addressing declines in revenue due to conservation or conservation incentives address customers’ concerns about reduced utility risk justifying reductions on authorized returns on equity which are built into rates? 6. How do the various mechanisms for addressing declines in revenue due to conservation address appropriate limitations on the scope of any allowed decoupling (as for example limiting the scope to residential and commercial natural gas sales customers) so as to not protect utility revenues from economic changes not having to do with utility conservation? |

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| Northwest Industrial gas Users (Continued) | <p>7. Do the various mechanisms addressing declines in revenue due to conservation or conservation incentives appropriately not impact transportation customers of natural gas utilities who buy their own natural gas commodity and do not have any cost relationship to the natural gas utility's commodity purchases or conservation efforts for their sales customers?</p> <p>8. How do the various mechanisms for addressing declines in revenue due to conservation or conservation incentives address the potential for excessive earnings by the natural gas utility?</p> <p>9. How does the promotion of direct use of natural gas fit in the context of overall efficiency in this inquiry?</p> |
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| The Energy Project | <p>1. Transparency: how direct and easily understood is any mechanism to incent a utility or remove their disincentive to invest in energy efficiency? Can one or how can one realistically evaluate the need to compensate a utility for the decline in revenues due to energy efficiency programs in isolation from the many other factors evaluated in a general rate case to determine whether a utility is earning an adequate return on their investment?</p> <p>2. Magnitude: Is the level of compensation provided commensurate with the effort and performance of the utility?</p> <p>3. Equity: How does one compensate for the disproportionate bill impacts such mechanisms are likely to have for low-income customers, particularly since they are far less likely to be able to participate directly in energy efficiency benefits.</p> <p>4. Symmetry: Can an incentive mechanism for DSM or a disincentive removal mechanism ever sufficiently adjust the imbalance created by a return on investment for supply side investments? If not, what is adequate, particularly considering #5 below? Can a mechanism that addresses the utility's disincentive for conservation adequately neutralize their profit motive to increase sales regardless? Does reducing the utility's disincentive for conservation result in a commensurate increase in the end user's disincentive to invest in conservation?</p> |

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| The Energy Project <i>(Continued)</i> | <p>5. Context: Do the directive that a utility provide service at the least cost to customers and/or the requirement from I-937 that a utility capture all cost-effective energy conservation obviate the need to further motivate utility efforts? (At least somewhat rhetorical, as experience seems to indicate that it does not.)</p> <p>6. Risk: What impact does the mechanism have on the utility’s risk profile and how is that adjusted for with regard to rate of return?</p> |
| Northwest Energy Coalition | <p>We recommend ensuring that any discussion of the impact of revenue recovery mechanisms and conservation incentives on utility rates and bills specifically addresses positive and/or negative impacts on low-income households. Low-income households must be able to access utility services they can afford.</p> <p>General Principles for Energy Efficiency Policy Package</p> <ol style="list-style-type: none"> 1. Aggressive energy efficiency targets should be a key component of any policy package addressing energy efficiency. 2. Utility incentives and disincentives should be aligned with the overarching goal of promoting acquisition of all cost-effective energy efficiency. 3. Utility disincentives for effective energy efficiency (such as regulatory incentives that reward increased sales and penalize sales below accepted levels, i.e., throughput incentive) should be addressed. 4. Utility incentives for energy efficiency investments and performance should be considered to help even the playing field with the incentives that may exist for supply-side investments. 5. Utilities should have timely cost recovery for prudent and cost-effective energy efficiency expenditures, including addressing the delay in cost recovery from increased energy efficiency program efforts. |

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| Northwest Energy Coalition (Continued) | <p>General Principles for Energy Efficiency Policy Package</p> <ol style="list-style-type: none"> 6. Consumers should receive the substantial majority of the net economic benefits (the difference between the benefits of the measure and its cost) of energy efficiency investments. 7. Cost effectiveness should include energy and non-energy benefits. Energy benefits include, but are not limited to: reduced generation costs, avoided losses, distribution and transmission costs, taking account of load shape, load factor, peak demand and locational benefits. Non-energy benefits may include, but are not limited to: reduced environmental damage, reduced water and other resources, health and safety benefits, and economic development. 8. Any mechanism that is found to significantly increase or decrease shareholder risk should consider including an appropriate increase or decrease in the allowed shareholder return. 9. Creation of an incentive mechanism or a disincentive removal mechanism should include detailed analysis of the positive and/or negative impacts of that mechanism on low-income consumers; analysis indicating an "average" condition for residential consumers is not sufficient. Implementing such a mechanism should not increase the difficulty for low-income households to access utility services they can afford. 10. 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, assuming there is unaddressed need. 11. An independent evaluation should be conducted to examine the effectiveness of an incentive mechanism or a disincentive removal mechanism. |

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| Northwest Energy Coalition <i>(Continued)</i> | <p>Principles for Addressing Disincentives to Energy Efficiency (Throughput Incentive)</p> <ol style="list-style-type: none"> 1. Any mechanism should be linked to a commitment from the utility to pursue significant energy efficiency savings. 2. As it removes the disincentive to decrease sales, any mechanism should also reduce the incentive to maximize sales as a way to increase profit. 3. Utilities should not be disadvantaged by energy efficiency achievements regardless of whether they are accomplished through end-use consumer programs, codes, standards or markets. 4. Master metering and straight fixed variable rate design are not acceptable solutions if they create a disincentive to consumer investment in energy efficiency. 5. Any mechanism should not erode a utility’s incentive to control costs or to improve operational efficiency. 6. The mechanism should not result in an unwarranted shift in costs between customer classes or to low-income consumers. 7. The mechanism should be designed to limit excess year-to-year fluctuations in rates. 8. Once in place, the mechanism should strive to be understandable and impose low administrative cost for the regulatory agency, the utility and public interest advocates. |

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| Northwest Energy Coalition (Continued) | <p>Principles Providing Incentives for Energy Efficiency</p> <ol style="list-style-type: none"> 1. The best resource mix for consumers should also be the most profitable path for utilities. 2. Utilities should have a timely earnings opportunity, in which earnings are directly linked to efficiency program performance. 3. The incentive mechanism should ensure that the substantial majority of benefits of energy efficiency are received by consumers and should be set no higher than is required to induce the sustained investments needed. 4. Incentives should reward superior performance. 5. Incentives should be designed to reward achievement of results equitably throughout all sectors to which the incentive applies, not just within a single sector. 6. Incentive rate design should avoid creating large changes in earnings from small changes in savings levels. 7. Performance metrics should focus on energy savings, economic savings, and carbon savings. 8. Additional indicators should be considered as performance metrics or as thresholds for receiving incentives, such as market transformation, hard-to-reach sectors, cost minimization, and maximizing cost-effectiveness and net benefits. |

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| Northwest Energy Coalition <i>(Continued)</i> | <p>Principles for Addressing Rate Design</p> <ol style="list-style-type: none"> 1. Retail rates should be designed to provide efficient price signals to consumers. 2. End-block rates should align the rates for incremental usage with long-run incremental costs, including production, transmission, distribution, administrative, and environmental costs. 3. Time-varying rates should not be implemented in a manner that creates severe hardships for consumers. |
| Cost Management Services, Inc. | <ol style="list-style-type: none"> 1. Remove the requirement that a customer who has received a conservation-grant and subsequently becomes an electric-transmission or gas-transport customer only must immediately pay back the grant. 2. It may be the case that building developers can receive conservation-grants while their tenet is a customer of the utility. The ability of the tenet to elect not to be a core customer under such circumstances further exacerbates the undue discrimination to customers who, having received a grant, face the threat of having that grant converted into a loan upon election of non-core service. 3. CMS questions the wisdom of providing grants for new construction. We believe the grant should be limited to funding replacements or retrofits at existing buildings. |
| Department of Ecology | <p>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 (<u>RCW 70.235.020</u>)</p> |