**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| In the Matter of the | ) | **Docket No. U-100522** |
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| Conservation Incentive Inquiry | ) | **NW Energy Efficiency Alliance's** |
| | ) | **Response to Consolidated** |
| | ) | **Issues List** |
| | ) | |

In accordance with the May 13 Notice of Opportunity to File Written Comments, the Northwest Energy Efficiency Alliance (NEEA) respectfully submits the following responses to the WUTC's consolidated list of issues in this docket. We do not respond to every question or sub-question raised in that list, but reserve the right to submit replies to responses from other stakeholders on the full list of issues.

The Northwest Energy Efficiency Alliance, an organization committed to maximizing the market adoption of energy efficiency in the region since 1997, has an interest in the long term capture of all cost-effective energy efficiency in the State of Washington, in particular, and the Pacific Northwest in general. Maintaining a strong commitment to the achievement of cost-effective energy efficiency by the Investor Owned Utilities (IOUs) operating in the State of Washington is a critical element of the regional partnerships needed to achieve aggressive efficiency goals. NEEA appreciates the discussions in this Docket, and respectfully submits our comments in an effort to serve the region as its partner in accelerating the market adoption of energy efficient products, services and practices. NEEA and its partners are committed to the transformation of markets towards greater energy efficiency. Success at such market change is an important underlying factor in these discussions.

Although we will provide comments based on the outline of the consolidated list of issues as requested by the WUTC, we believe that an integrated and comprehensive approach to the issues may not occur from looking at the issues in isolation. Therefore, we have included some suggestions for a potential integrated approach in Item 24: "Other Issues."

In addition, we want to bring to the forefront three overarching concerns: (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.

We will not attempt to comment on every issue, but only those to which we can productively and appropriately contribute.

## General

*1)* *Definitions.* What is decoupling? What is lost margin? How is it measured? What are fixed costs?

*2)* *Recovery of Conservation Program Costs.* Are the utilities' conservation program costs recovered from ratepayers in a timely manner?
a. If cost recovery is untimely, please describe how and why.
b. Are there other methods of funding conservation programs that would be more efficient and effective at acquiring conservation resources?

## Impact of Conservation Resource Development on Rate of Return

*3)* *Statement of the Issue.* Does the development of conservation resources deny the utility an opportunity to earn its allowed rate of return?

Response: There is no intrinsic reason that a utility would be denied the ability to achieve its "rate" of return simply because it develops conservation resources. The allowed rate of return (ROR) or return on equity (ROE) depends on rate cases and regulators. What is clear is that without an incentive structure the absolute dollar value of the ROR will be less with conservation resources when compared to a similar investment in generation.

*3)* *Statement of the Issue.* Would an attrition study be the best way to determine this question? Are there alternative ways of making such a determination?

Response: Modeling with known assumptions may provide insight and can be used before establishing any specific policies about incentives. We recommend, for example, the short paper by Cappers, et al on "Quantitative Financial Analysis of Alternative Energy Efficiency Shareholder Incentive Mechanisms[1]," or the longer report "Financial Analysis of Incentive Mechanisms to Promote Energy Efficiency: Case Study of a Prototypical Southwest Utility[2]."

*4)* *Magnitude of the Risk.* 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?

Response: We interpret this (these) questions to refer to "how much margin may be lost due to declining sales?" that is caused by each of the sub-categories of load loss in Item 6 below. Each of those categories can result in some decline in loads, with many acting in combination with other factors. In fact, in order to achieve the scale of conservation

[1] Cappers, P., Goldman, C., Chait, M., Edgar, G., Schlegel, J. and W. Shirley. "Quantitative Financial Analysis of Alternative Energy Efficiency Shareholder Incentive Mechanisms." Proceedings of the Summer Study of the American Council for an Energy Efficient Economy, Washington, DC, August 2008 (Pp. 5-58 – 5-72).

[2] Cappers, P., C. Goldman, M. Chait, G. Edgar, J. Schlegel, and W. Shirley. "Financial Analysis of Incentive Mechanisms to Promote Energy Efficiency: Case Study of a Prototypical Southwest Utility." LBNL-1598E. March 2009

sought by I-937 the WUTC actually requires that multiple influences be applied. The combination of these and their interrelationships may actually be so intertwined and complexly related that their segregation leads to false indications. Thus a), b), and c) below almost always act together, in many cases leading to e). Similarly, d), f), and g) are part of the same customer initiated responses to markets and new technologies. In fact, failing to invest in cost-effective conservation will by definition lead to higher utility cost structures that will raise consumer costs and create the reactions of elasticity (f) and substitution (g). Some would argue that independent consumer purchases of efficient emerging technology, sensitivities to energy price increases, and subsequent fuel substitution for price reasons (or combined with other desired attributes) may already be part of the utility forecast used to set cost recovery, ROR, and rates. NEEA believes 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. In our experience, the analytic effort required is not likely to produce the desired clarity and more importantly is not necessary to establish a strategic system of incentives to utilities.

*5)* *Direct Conservation Incentives and Rate of Return.* What is the rationale for making incentive payments to utilities for acquiring conservation resources? Is it to encourage conservation? (See Items 14 -17 below, relating to conservation mandates.) Is it to ensure that the utility earns a sufficient rate of return?

Response: NEEA sees the best role of incentives is to maximize acquisition of all cost effective conservation in Washington over the long term. Incentives, if structured properly, can act in a multi-faceted way. First they can avoid or offset natural business dis-incentives that discourage utility funded conservation efforts. They can also make conservation a potential profit center, allowing the IOUs to direct their best staff and resources to support it. Incentives also provide the opportunity, if used in a flexible and strategic manner, to assure that multiple, desirable, state policy objectives are met. Incentives focus attention on high priority goals. Properly designed incentives would, for example, make sure that the long term benefits of achieving market transformation are recognized and rewarded for the cost-effective and cost-efficient resources they are. Such targeted recognition and reward would focus more attention on goals such as market effects and do so in a more strategic way than occurs with more simplistic incentives. Care needs to be exercised so that incentive mechanisms do not result in perverse effects.

Conservation incentives alone do not assure that the utility will earn a sufficient rate of return. They may contribute to that end. The assurance of rate of return sufficiency is at the heart of the regulatory rate case process.

*5)* *Direct Conservation Incentives and Rate of Return.* Does an incentive program act as an effective substitute for decoupling?

Response: The Cappers et al. paper cited above illustrates 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.

**Details of a Conservation Incentive Mechanism**

*6)* *Categories of Lost Margin Due to Conservation Eligible for Recovery.* 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:

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).

b) Information provided by the utility to the customer, such as educational programs, bill inserts, or information on the utility's website.

c) A 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 conservation savings that occur for the purposes of a cost recovery mechanism?

d) Independent customer conservation efforts (no rebate or direct utility assistance documented).

e) Conservation due to codes and standards.

f) Elasticity (i.e., heating fewer rooms, lowering thermostat, et cetera).

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.

h) Other (describe).

Response: As we indicated above in Item 4, each of the categories listed here can be responsible for some decline in loads, with many acting in combination with other factors. Each can lead to desirable and cost-effective conservation. In fact the scale of conservation achievements sought by I-937 and the WUTC actually require that multiple influences be brought to bear. Thus a), b), and c) above almost always act together, in many cases leading to e). Similarly, d), f), and g) are part of the same customer initiated responses to markets and new technologies. In fact, failing to invest in cost-effective conservation will by definition lead to higher utility cost structures that will raise consumer costs and create the reactions of elasticity (f) and substitution (g). Some would argue that independent consumer purchases of efficient emerging technology, sensitivities to energy price increases, and subsequent fuel substitution for price reasons (or combined with other desired attributes) may already be part of the utility forecast that is used to set cost recovery, ROR, and rates. NEEA believes that trying to separate out attribution of each of the causes of load loss (or reduction below what it might have been) is both analytically intractable and unnecessary to provide adequate incentives to IOUs in Washington.

Much of what impacts lost revenue or load decline in the factors cited has to do with changes in baseline of energy use and energy efficiency from the inter-relationship of these factors. These effects reflect changes in markets which, ideally, occurred because of the utility's, and other actors' combined efforts to stimulate long-term change. Their occurrence has positive benefits to the utility system, to long-term ratepayer bills and to the economic environment of the state.

Although NEEA evaluates and identifies regional cost-effective savings, they are a result of a multiparty collaborative to achieve a common goal. In response to sub-item c) above, NEEA efforts contribute to long term ratepayer benefit and should be part of any cost recovery, but isolating the savings is not necessary to do this.

*7)* *Impact of Conservation Incentive Mechanism on Utility Incentives to Encourage Consumption.* 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?

*8)* *Offsets.* To what extent should any recovery of lost margin be offset by revenues associated with new load (sometimes referred to as "found margin"), including:

a) New customers,

b) Additional load for existing customers,

c) Other?

*9)* *Application to Industrial Customers.* 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.

Response: The question inappropriately focuses on costs rather than benefits. All consumers in the market, large and small, benefit from the IOU's reduced costs of resources and from lower wholesale prices due to reduced demand in the west coast market. There is no reason to exclude some class of customer from sharing in the costs and benefits of an aggressive and comprehensive conservation program. Large customers, small family farm customers, governmental customers, school districts, low income customers all benefit from the lower cost of power that comes from a cost-effective conservation program.

*10)* *Other Characteristics of an Incentive Mechanism.* What characteristics should an incentive mechanism include?

Response: An incentive mechanism should be designed to accomplish all of the objectives that are desired. It must not target a simple solution and assume that other policy goals will automatically be met. For example, if long term market effects or market transformation savings are not called out in the mechanism, the Commission

shouldn't expect that these savings will be emphasized by the utility. In addition, the mechanism should be transparent, with risks to ratepayers limited. The mechanism should be integrated and internally and externally consistent. (See NEEA responses to Item 24).

a) Should it allow the utility to recover an absolute dollar amount? If so, how should the amount be calculated?

Response: An absolute dollar amount would be transparent, and would limit the maximum costs of the mechanism. It would be reasonable to calculate the amount as a proportion of the amount of resources approved by the Commission for the program operation. The amount should be high enough to get the attention of utility management.

a) 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?

Response: There are serious risks in choosing an incentive mechanism that is based solely on "net" savings attributable only to utility programs. First, it would be inconsistent with the way the I-937 targets are set, and the way that the Total Resource Cost (TRC) is calculated. Second, the measurement issues are non-trivial, and exact attribution would be unattainable even in a simple world. Third, the world is not simple. The utilities once were the major drivers of energy efficiency, but are currently only one force in the market. We have green house gas and global warming awareness. There are non-energy entities like the Green Buildings Council, LEEDS, the 2030 Challenge and Sustainability coalitions active in the market. Large retailers like Wal-Mart, Costco, and Lowes are pushing efficiency and partnering with Energy Star. Further, there are tens of millions of dollars in ARRA funds going into the marketplace along with federal tax credits. Isolating the exact influence of the utility in this dynamic market is a chimera. Fourth, in order to achieve the ambitious goals of the Commission and I-937, many partners need to work together. Often this collaboration, whether with organizations like NEEA or manufacturers, installers and retailers is most effective when there is no need to parse out who gets credit. Forcing an IOU to depend for its incentive on only what they can prove they are responsible for is likely to be counterproductive. The goal ought to be changes in market level demand, which is measurable, but not necessarily attributable to each factor.

b) For electric utilities, should the incentive targets be different and greater than the Energy Independence Act (EIA or I-937) targets?

Response: As reiterated in Item 15, NEEA believes the most useful way to set the targets would be to accelerate conservation acquisition beyond the two-year minimum accomplishments required by I-937, and to use the incentive to focus the utilities on longer term savings, lost opportunities, and other strategic objectives..

c) Should there be penalties for failing to achieve the incentive mechanism's target or rewards for achieving only a percentage of the target?

Response: There are sufficient penalties under I-937 to create risk for non-performance. Withholding the designated incentive should be a sufficient disincentive to failure to achieve the savings above I-937. 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. A proportional reward structure may be less contentious.

d) Should there be an earnings test to determine if the utility is over earning?

e) Should the incentive include all customer classes in the target and in the collection of the incentive payments?

Response: All customers directly benefit from lower costs than otherwise if energy efficiency is purchased in lieu of market based power, so all should pay part of the incentive. Some individuals may benefit even more by directly taking part in a program offering, lowering their costs still further. A well-balanced portfolio should provide opportunities to participate for most rate-payers.

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.

**Impact on Rates**

*11) Impact on Various Classes of Customers.* 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?

Response: Again, the emphasis is on costs rather than on the benefits of the conservation load reductions – and on rates rather than on bills. The benefits to consumers beyond the obvious environmental benefits, are the total of the lower bills for service due to the utilities' purchase of the least-cost resources, the potential bill decreases due to participation in utility rebate programs, living in more efficient buildings due to code improvements, having access to more efficient appliance options in the market due to market transformation, awareness of better behavioral alternatives due to IOU marketing and education efforts, and advances in codes and standards. Many, if not most, of these are long term benefits -- benefits extending well beyond the two year time frame of I-937. All core customers of the utilities benefit from each of these opportunities to varying degrees. The transport customers' benefits are smaller, but it would be short-sighted to miss the fact that aggressive conservation programs reduce the demand for fuel in the west coast market place, and thus drive down the cost of the fuel to all consumers as the available supply stays the same and demand decreases. Accordingly, there is some

reason to expect that transport customers should pay for some of the benefits bestowed by an effective utility conservation program.

*12)* *Impact on Low Income Households.* 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?

*13)* *Impact on Utility Incentives.* 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?

**Relationship of Incentives to Conservation Mandates**

*14)* *Impact of Conservation Mandate in I-937.* 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?

Response: This is a threshold question that needs to be decided before engaging in discussions of specific mechanisms. NEEA would argue 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. The chief arguments for the appropriateness of incentives are:

1) I-937 establishes targets in a more concrete fashion than the general "all-cost-effective" requirement. The targets and penalty clauses are based on pro-rated two-year accomplishments toward a 10 year target. A utility can avoid the penalties by meeting the minimum target, yet the potential benefits to the State and the ratepayers go beyond the minimum, two-year requirements and are not encouraged or targeted presently. Incentives to go beyond the minimum targets would be useful in encouraging longer-range effects.

2) The methodology of the Power Council that underlies the implementation of I-937 recognizes the value of achieving cost-effective conservation ahead of schedule for lost opportunity resources in particular. Incentives that promote the capture of lost opportunities as part of meeting the two-year targets are desirable as a way to avoid focus on the easier-to-obtain, but less valuable retrofit/discretionary resources. With regard to Item 15 below, the actual operation of I-937 is on near-term resource acquisition. Overachieving in any two or four year period would not mean paying for non-cost-effective resources, but would accelerate the capture of currently identified cost-effective resources in the near-term. Future events and forecasts may result in additional measures being identified as cost-effective in the future.

3) Energy efficiency is a quality-intensive resource. There is a difference between running programs and running them well. Incentives may result in more management attention and more resources being applied to do difficult energy efficiency well. This is important too with regard to Item 16 below, because the recent over-achievement of conservation targets by the IOUs was driven in large part by inexpensive and easier savings from CFLs. Most parties in the region acknowledge that the next round of targets will be harder to achieve. More creativity, staff and budget may be needed to exceed future goals, and go the extra mile.

*15)* *Incentives to Exceed I-937 Targets.* 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?

Response: By definition, ratepayers are not benefited by paying for non-cost-effective resources. However, this needn't be an issue in the foreseeable future. Refer to responses to Item 14 above.

*16)* *Impact of Disincentive.* 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?

*17)* *Natural Gas Planning.* 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?

**Evaluation, Measurement and Verification**

*18)* *Use Per Customer as a Metric.* Is use-per-customer for individual rate classes a useful metric for identifying conservation effects?

Response: Theoretically, this is an attractive performance metric, especially if policy goals are directed toward an absolute reduction ("zero net energy") or an absolute reduction in green house gases, as opposed to reductions below what otherwise would have occurred. It is also a good long term societal metric. However, as a metric with immediate and very specific consequences in a shareholder incentive environment, the challenges to equity and measurement are fairly intractable. Savings are measured at a particular point in time. Consumption is similarly measured at specific points in time. What "otherwise would have been the consumption" at that point in time is an important

issue. Multivariate analyses can be a first level effort to control for historical factors that effect per capita consumption, but within any short period of time – two- three years, the changes due to outside forces on entire markets, will swamp the signal from energy savings for the small fraction of the market that participates in a utility program. It is important to keep the scale of what can be accomplished in a three year program period in perspective. For the 2006-08 program cycle, California spent $2 billion on a good energy efficiency program (and $80 million on evaluation), but the total net savings over three years was equivalent to only 1.3% of the total electric sales over the same three years[3]. This strong signal can still be lost among the other variations in loads. Failure to control adequately for massive changes such as the recent housing bust and recession on loads can lead to major incentive payments. The adoption of higher powered personal computers and larger flat screen TVs could apparently nullify a successful IOU efficiency program. But off-setting load growth does not nullify the value of those programs; it only makes their measurability complex.

In addition, the concept of measuring per capita consumption and controlling for unrelated outside influences in industrial, agricultural, institutional, governmental, and large and small commercial applications is dauntingly harder than simple residential per capita consumption.

Because of these factors, such metrics are not useful for measuring short-term changes in the market loads for purposes of rewarding utilities.

*19)* *Load Forecasting.* 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?

Response: The relationship between forecasts, resource choices, and conservation has been a difficult issue to tackle for the last 30 years. Forecasting isn't getting easier. The high and low bounds of the forecast can help determine the conservation potential. Achieved conservation should be taken as part of the baseline in subsequent forecasts. Yet forecasting remains much 'art' and increasingly, science.

*20)* *Methods for EM&V.* Should the Commission establish a method, or general guidelines for an evaluation, measurement and verification (EM&V) methodology?

Response: The Commission has a role in setting standards by which achievements are measured for purposes of regulatory incentives. However, it need not re-invent the wheel. A number of existing EM&V protocols are available, such as the International Performance Measurement and Verification Protocol (IPMVP) and the California *Protocols for Evaluators*[4]. In addition, the Regional Technical Forum (RTF) established

[3] Draft "2006-08 Evaluation Report," California Public Utilities Commission, Energy Division, April 17, 2010. p. ii.

[4] Available at http://www.calmac.org/events/EvaluatorsProtocols_Final_AdoptedviaRuling_06-19-2006.pdf .

in federal appropriations language, serves the purpose of establishing savings and cost-effectiveness for deemed measures, simplified M&V protocols for frequent and similar measures, and standards for M&V of custom measures.

NEEA recognizes that EM&V protocol development is an ongoing process that must evolve along with innovations in energy efficiency (e.g., behavior-based initiatives). We support a consensus-based approach to protocol development, and encourage the Commission to work with organizations that are already engaged in protocol development in order to help prevent duplication and unnecessary divergence of effort.

NEEA recognizes that current practices of evaluation are not consistent across utilities or across the states in the region. The variability of evaluation techniques and practices is problematic because it may contribute to an erosion of confidence and support for energy efficiency efforts. We believe it would benefit both Washington and the region's energy efficiency efforts if Washington and other state Commissions were to encourage standardized approaches to EM&V.

a) What role should a third party evaluator of EM&V play?

Response: The goal should not be absolute dependence on third party measurement, but independence and objectivity. Third party evaluators help to ensure independence in the evaluation function. Third party evaluators may work for a utility (or other efficiency provider), but their reputation and future work depends on their maintaining objective independence.

Utilities can realize the benefits of a third-party evaluator whether they hire the evaluator to conduct the majority of EM&V activities or to play a substantially smaller role by simply verifying the measurement and verification work conducted by in-house utility evaluation and/or engineering staff. It has been NEEA's experience that the quality of evaluation and measurement depends more on the process than how large a role the third party evaluator plays. Effective EM&V depends on a process that is transparent, includes oversight, and in which a knowledgeable staff member of the energy efficiency organization has responsibility for ensuring objective and replicable results.

b) Are EM&V methods accurate enough to use the history of individual customer usage as the basis for determining the payments in an incentive mechanism?

Response: It depends on the type of incentive mechanism. EM&V methods based on widely accepted and substantiated statistical and analytical techniques (such as those described in the various existing protocols) are considered accurate and reliable. However, like all statistical methods, they can never be considered absolutely precise; statistical methods provide a way to estimate with the greatest accuracy possible, but the

result is still an estimate. Thus, EM&V methods can appropriately be used as a basis for payments, but it would be inappropriate to rely upon them in situations where absolute precision is required. For example, they are not sufficiently accurate as the basis for threshold-based incentives (e.g., where 59.5% gets nothing and 60% gets millions)

c) What role should the Regional Technical Forum play in EM&V issues?

Response: The Regional Technical Forum currently plays a key role in establishing regional M&V protocols. It establishes, via a public process, savings and cost-effectiveness for deemed measures, simplified M&V protocols for frequent and similar measures, and standards for M&V of custom measures. As noted earlier, NEEA believes there is value to the region in adopting consistent approaches to EM&V across the region. Given its charter and the consensus-based approach that it takes, the RTF could play an even greater role in helping move the region toward consistent EM&V protocols.

*21)* *Impact on Cost-Effectiveness of Conservation Measures.* 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?

Response: 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 as much as installation costs, taxes, administrative oversight, program quality control, and trade ally profit margins are part of the total resource cost.

How much the payment of incentives would add to the cost of the efficiency resource would depend on the nature and size of the incentive. Once this is known, a detailed analysis might be tested to see what effect it would have on the total resource potential. Given that the conservation resource tends to be much less costly and risky than alternative resources, and that cost-effectiveness is best judged on the portfolio level of the utility investment, any reasonable incentive payment is likely to have a negligible impact on the total resource over the planning horizon. Cappers, et al, found only one proposed incentive mechanism (where the utility was to be given 90% of the normal return on investment for the value of the saved energy and demand) actually drove the portfolio TRC cost-effectiveness below 1.0[5].

**Relationship of Conservation Incentives to Utility Return on Equity**

*22)* *Effect of Incentive Mechanism on Allowed Return on Equity.* Should adoption of an incentive or lost margin/decoupling mechanism require a downward adjustment in the utility's return on equity?

[5] Cappers, P., Goldman, C., Chait, M., Edgar, G., Schlegel, J. and W. Shirley. "Quantitative Financial Analysis of Alternative Energy Efficiency Shareholder Incentive Mechanisms." Proceedings of the Summer Study of the American Council for an Energy Efficient Economy, Washington, DC, August 2008 (Pp. 5-58 – 5-72).

*23)* *Incentive Rate of Return.* 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?

**Other Issues**

*24)* *Other Issues.* Comment on any other issue relevant to this inquiry that is not covered above.

Response: NEEA is concerned that responses to diverse sets of specific questions do not encourage a vision of an integrated approach to a shareholder incentive mechanism. Questions, such as can the utility "over-earn?" (Item 10, d) would not be part of the picture if the incentive structure were based on an absolute dollar value. Because all mechanisms have problems and potential for unintended consequences, NEEA believes that the formulation of an incentive policy needs to be done in a manner that is internally consistent and comprehensive. We provide here a 'straw' proposal for keeping the dialogue focused on what we believe to be critically important outcomes.

Our assumption is that the purpose of the discussion of incentive mechanisms is to find a way, if determined to be necessary and prudent, to motivate Washington IOUs to become even more proactive and focused on conservation than is currently required by law. If the purpose of the Docket was to determine the best way to mitigate the ROR impacts on state IOUs due to I-937, this could be determined in rate cases. The Commission finding that it is to the advantage of the State and the ratepayers to do even more energy efficiency than is required in the near term under I-937 demands a mechanism which makes energy efficiency sufficiently attractive to the IOUs that they will expend the required effort to achieve more of it.

One approach is to determine an absolute dollar amount maximum that can be earned in increments as accomplishments increase. This would be both transparent and cost limiting. The maximum amount should be based on the size of the total conservation investment plan, and not just the amount dedicated to the accelerated conservation above I-937. Doing so avoids possible complications from tracking and reporting savings from programs associated with incentives versus those required to meet I-937 mandates. The actual amount of the incentive should be negotiated to be sufficiently attractive to create extra effort, focused on the desired policy outcomes, and keep the shareholders closer to neutral despite the incremental conservation.

The metrics for success are crucial. A large fraction of the reward structure can be dependent on savings of kWh in excess of the requirements under I-937, another fraction would be dependent on creating market effects or progress toward long term market transformation, and other fractions can 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.. These supplemental requirements

can be placed on the whole portfolio, the initial I-937 and the accelerated conservation, but rewarded from the incentive pool. The savings would be measured consistent with the way they are measured for I-937 – gross savings from all sources that are measured in EM&V. In this way the marketing and outreach, educational efforts, work with NEEA, pilots, small coalitions, the federal government or other multi-partner efforts can all contribute to the overall conservation achievement.

The timing ought to be multi-year, perhaps two cycles of I-937, to allow for full integration and synergy among programs. Even then, full market effects won't be accomplished, but surrogates for savings – metrics of intermediate progress, can be developed. Process and market evaluations can supplement the acquisition program savings evaluations to provide metrics for the other fractions of the reward structure.

While some may argue that breaking up the reward structure into so many pieces adds complexity, it remains true that only what gets rewarded will be measured well, and only what gets measured will be pursued with focus. The rewards need to be attached to the goals.

In summary, NEEA believes that there is an argument to support properly structured incentives that will maximize acquisition of cost effective conservation to Washington state consumers over the long-term. Incentives should be multi-faceted and structured to reward long-term efficiency efforts and market effects, as well as short –term resource acquisition. Finally, the incentives should be structured to ensure the opportunity for broad program participation by all rate-payers in order to ensure that consumers in Washington State will have the lowest possible total energy bills.