BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WUTC v. PSE

DOCKET NOS. UE-060266 and UG-060267

DIRECT TESTIMONY OF ELIZABETH C. KLUMPP (ECK-1T)

ON BEHALF OF

PUBLIC COUNSEL

JULY 19, 2006

DIRECT TESTIMONY OF ELIZABETH C. KLUMPP (ECK-1T)
DOCKET NOS. UE-060266 and UG-060267

TABLE OF CONTENTS

PAGE

TABLES

ELIZABETH C. KLUMPP'S EXHIBIT LIST

Exhibit No. ___ (ECK-2)	Qualifications and Experience of Elizabeth Chapman Klumpp
Exhibit No. ___(ECK-3)	Electric Efficiency Incentive-Penalty Mechanism
Exhibit No. ___(ECK-4)	Design Criteria for Electric Efficiency Incentive Mechanism
Exhibit No. ___(ECK-5)	PSE Response to NWEC Data Request No. 22

I. INTRODUCTION / SUMMARY

Q. Please state your name, employer, and present position and role in the case?

A. My name is Liz Klumpp. I am a Senior Energy Policy Specialist at the Washington State Department of Community, Trade and Economic Development (department). In this case I am a consultant to the Office of Public Counsel (Public Counsel).

Q. Have you provided an exhibit describing your education, relevant employment experience, and other professional qualifications?

A. Yes, I have. It is Exhibit No. ____ (ECK-2).

Q. Briefly describe your current duties.

A. My current work responsibilities include managing staff that provide data support to the department, implement the fuel mix disclosure reporting process for over sixty electric utilities in the state, and produce the Green Power Report annually to the legislature. More directly, I am responsible for tracking progress and developing and analyzing policy options on electricity and natural gas issues including resource demand, and costs and benefits of various demand-side management and resource supply options, energy-related emission reduction strategies, state and federal product and building energy efficiency standards, and voluntary and regulatory sustainability building practices. My duties include advising the agency management, Governor's executive policy staff, state legislators, and state employees on these issues.

Q. Have you previously submitted expert testimony to the Commission?

A. Yes. I submitted expert testimony on behalf of Public Counsel in support of the Conservation Settlement in Puget Sound Energy's 2001 general rate case.[1] The Company has incorporated a copy of the 2002 Conservation Settlement in this case record as Exhibit No. ___ (CES-3).

Q. What is the focus of your testimony today?

A. My testimony focuses on the Company's proposed incentive-penalty mechanism for achieving conservation among its electricity customers, as set forth in the testimony of PSE witness Mr. Calvin Shirley.[2] Public Counsel recommends that the Commission reject the Company's proposal and in its place consider Public Counsel's recommended proposal as described in my testimony and outlined in the attached Exhibit Nos. ____ (ECK-3) and (ECK–4).

Q: Please briefly describe PSE's current conservation program as established by the 2002 Conservation Settlement and relevant background information.

A. For several years prior to their 2001 general rate case, PSE failed to offer robust energy efficiency programs and consequently, the Company's performance in achieving conservation savings was quite low. As part of the global settlement of PSE's 2001 rate case, the Company committed to a renewed focus on its energy efficiency programs, as expressed in the 2002 Conservation Settlement. Under the terms of that settlement, the Company agreed to initial targets for achieving electricity and natural gas conservation

[1] *WUTC v. Puget Sound Energy*, UE-011570 and UG-011571, Twelfth Supplemental Order (Approving and Adopting Settlement Stipulation), June 20, 2002, Exhibit F to Settlement Stipulation, (hereafter, "2002 Conservation Settlement").

savings, and to a process whereby two-year targets would be established in consultation with the Company's Conservation Resource Advisory Group (CRAG). PSE faced potential penalties if they failed to meet those two-year targets. (Section M. of 2002 Conservation Settlement, at ¶¶39-46). The 2002 Conservation Settlement called for the Company to create the CRAG, which is composed of representatives from Commission Staff, Public Counsel, industrial customers, the Northwest Energy Coalition, CTED, and other stakeholders. The Company met its conservation targets, on average, in 2003, 2004 and 2005. These conservation programs are funded through an electric tariff rider, Schedule 120, through which ratepayers fund these conservation acquisition programs.

Q. What incentive or penalty mechanisms are now in place for the Company?

A. There is a no incentive mechanism currently in place for the Company. The 2002 Conservation Settlement outlines a penalty mechanism ranging from $200,000 to $750,000 that shareholders pay in the event the Company's performance falls below an established target level of achieved conservation savings. In that agreement, the performance was averaged over two years to account for fluctuations in capturing conservation. As noted above, the Company has met its targets and has not paid penalties under the settlement.

II. FLAWS OF THE COMPANY'S PROPOSED MECHANISM

Q. Why do you recommend that the Commission reject the Company's incentive-penalty mechanism?

---

[2] Exhibit No. ____ (CES-1T), pp. 3-19.

A. PSE's proposed incentive mechanism has several significant flaws. The first major flaw is that the Company's proposed mechanism would reward the Company based on the amount of money it spends to achieve the electricity savings. While the Company's proposal attempts to provide a higher incentive for higher conservation achievement, and we agree with that general principle, we strongly disagree with the Company's proposal to calculate the incentive amount based on the amount of ratepayer funds expended on programs. We think this is a very serious design flaw that may unintentionally encourage the Company to spend more than necessary to achieve conservation within their service territory. In this regard, PSE's incentive payment mechanism would create strong incentives *against* cost-effectiveness and cost control in the acquisition of energy efficiency resources.

A second major flaw with PSE's proposed mechanism pertains to the Company's proposed "targets" and when the financial incentives and penalties would begin. The Company's proposed annual budget of $29 million[3] is associated with an annual conservation target of 20 average megawatts (MWa), not the 16.5 MWa "baseline" target as proposed by the Company. The Company proposes that incentives be awarded upon achievement of 16.5 MWa, even though this is roughly 25% below the Company's budgeted target. Similarly, the Company proposes penalties that would not be paid until the Company's achievement drops below 13.2 MWa. Given that the budget is designed to support a target of 20 aMW, this trigger level for penalties is too low.

[3] Exhibit No.___(CES-5) Electric Program Cost Effectiveness Estimate.

Third, we oppose the Company's proposed penalty amounts because they do not provide adequate funding at any of the penalty levels to accomplish conservation through a third party contractor in the event of failure to perform.

Lastly, it is essential to create some program criteria to ensure that the Company maintains a minimum level of performance in all customer sectors, and to ensure that the Company continues to invest in longer-term conservation measures not just the more affordable short-term measures. It is imperative that electric companies preserve investments in long-term or "lost opportunity" conservation measures such as new construction or HVAC equipment. Public Counsel proposes a set of program criteria in connection with its alternative incentive/penalty mechanism. (Exhibit No. ___(ECK-4)). Public Counsel and Commission Staff agree on the design criteria and have agreed to jointly support these criteria in their alternative proposals in this case.

III. PUBLIC COUNSEL'S RECOMMENDATIONS

Q: Does Public Counsel propose an alternative incentive mechanism?

A: Yes. The balance of my testimony as well as Exhibit Nos. ____ (ECK- 3) and (ECK - 4) outline Public Counsel's proposal for an electric energy efficiency incentive – penalty pilot mechanism. The goal of the incentive design is at least to neutralize the disincentives that may discourage the Company from achieving conservation, particularly accelerated cost-effective conservation, and hopefully, to provide a meaningful incentive to the Company to pursue conservation for the least cost resource that it is. If successful, the incentive will encourage the Company to pursue conservation aggressively, thus securing economic value for its ratepayers and environmental value more broadly.

Q. Is Public Counsel's proposal consistent with the 2002 Conservation Settlement?

A. Yes, in general. The proposal is consistent with the overall goals of the settlement to improve PSE's acquisition of energy efficiency. However, all the incentive/penalty mechanism proposals in the case, including Public Counsel's, modify certain portions of the 2002 agreement in order to establish the new mechanisms.

Q. Why does Public Counsel propose an electric efficiency incentive mechanism at this time for this Company?

A. Fundamentally, each investor-owned electric utility in Washington, under WAC 480-100-238, the Integrated Resource Planning Rule, "has the responsibility to meet its system demand with a least cost mix of energy supply resources and conservation" whether or not it is awarded an incentive. That said, companies approach this requirement with levels of commitment or dedication that can vary dramatically from year to year and from company to company. Public Counsel has determined to support an electric efficiency incentive level in this instance for PSE for the following reasons.

1) The Company has demonstrated it has the professional capability and corporate commitment to aggressively pursue conservation prior to requesting an incentive mechanism. In this specific case the Company is pursuing electric conservation at an accelerated rate – 133% faster than its 2005 resource plan indicated as the average annual achievement. The Northwest Power and Conservation Council (NWPCC) estimates that the company's share of the regional conservation target is approximately 17 MWa (this counts PSE's share of savings through regional Northwest Energy Efficiency Alliance (NEEA) programs which the Company has not claimed through

2005). While prorating a portion of the NWPCC's regional target to the Company is at best a rough estimate, it is one more indicator that the Company is capturing conservation at an accelerated pace.

2. The Company has conducted some of the most rigorous energy efficiency resource analysis in the state or region beginning with the publication of its 2003 Integrated Resource Plan where it began to investigate the economic value to its ratepayers of accelerated conservation acquisition.

3. The Company's conservation targets increased with the 2001 general rate case settlement from approximately 7-8 MWa of annual achievement in 2000-2001 to at least 15 MWa in the settlement to the current annual performance of 20 MWa in 2004 and 2005.

4. The Company and its external stakeholder advisory group (CRAG) and Commission Staff have gained experience with the resource analysis and target-setting methodologies by virtue of the Company operating under a penalty mechanism since the 2002 stipulation agreement for the 2001 general rate case.

5. Public Counsel recognizes that capturing conservation secures financial benefits to the Company's ratepayers. The NWPCC's regional analysis indicates that accelerating the rate of acquisition of conservation reduces the net present value of both power system risks and power system costs.[4] Additionally, the NWPCC reports that conservation brings the following value to the region's power system, "…the Council's portfolio analysis shows that sustained, significant development of cost-effective

[4] Northwest Power and Conservation Council, http://www.nwcouncil.org/energy/present/aceee.pdf slide 14.

conservation now, with a goal of 700 MWa during the next five years, is in the region's interests. Accomplishing this and additional conservation during the remainder of the planning period reduces the average system cost by nearly $2 billion and reduces risk even more, compared to less aggressive implementation. This is in relation to an average system cost of operation and system expansion of approximately $24.5 billion.[5]" PSE appears committed to securing this financial benefit for its ratepayers.

Q. What savings target does Public Counsel recommend for purposes of determining the incentive payments?

A. We believe the appropriate savings target is 20 average megawatts (MWa), for purposes of evaluating the Company's performance and determining incentive payments. This is one-half of the two-year savings goal that the Company filed November 29, 2005, to the commission in its 2006-2007 Program Targets and Budgets. (See PSE Response to NWEC Data Request No. 22, included as Exhibit No. ____ (ECK-5). The Company sometimes refers to this as their "stretch target." While this is a very aggressive target for the Company, nearly three times its annual conservation achievement in 2000 or 2001, it is the target resulting from the conservation resource analysis, conducted by the Company in cooperation with the Conservation Resources Advisory Group, and the budget was established as a means to reach this target. This conservation resource analysis was typically performed biennially in the context of the Integrated Resource Plan. However, the Company is now proposing to conduct this analysis annually in order

[5] Northwest Power and Conservation Council, *The Fifth Northwest Electric Power and Conservation Plan,* 2005, pg 30.

to set an annual target.

Nevertheless, this is a very aggressive goal and represents capturing conservation at an accelerated pace, not common among Northwest utilities. Consistent with the 2001 rate case settlement on conservation, PSE currently faces a potential penalty – granted, a much smaller penalty than proposed here - if they fail to achieve 33 MWa during the 2006-2007 period (or 16.5 MWa annually). The 16.5 MWa annual target is therefore sometimes referred to as the "penalty" target or the "baseline" target.

Recognizing that the 20 MWa target represents an aggressive goal, and that the Company currently faces potential penalties if their performance falls below 16.5 MWa, we propose to provide the first level of incentives at 90% of the 20 MWa target, or for 2007, at 18 MWa. In this regard, our proposal has a "dead-band" from 80% to 90% of the Company's "stretch" target, which is currently 20 MWa.

Table 1 below shows the basic framework of Public Counsel's proposed mechanism, based on these targets and parameters. The full detail of the proposal is set out in Exhibit No. ___(ECK-3).

/ /

/ / /

/ / / /

/ / / / /

/ / / / / /

Table 1. Framework of Recommended Incentive-Penalty Mechanism

Incentive ranges based on % of Conservation Target achieved (20 MWa for 2007)	**MWa Saved**	**Penalties/Incentives**
		Incentives
> 120%	24	
110 - < 120%	22	*Incentive rate per MWH increases as performance improves*
105 - < 110%	21	
100 - < 105%	20*	
95 - <100	19	
90 - < 95%	18	
DEADBAND 80% - <90%		**Penalties**
70 - <80%	15.8	
60 - <70%	13.8	*Penalty rate per MWH increases as performance worsens*
50 - < 60%	11.8	
<50%	9.8	

*20 MWa is the target PSE filed in Nov/Dec 2005, and the amount for which the company collects funds from ratepayers.

Q. What method does Public Counsel recommend to determine the incentive payment levels?

A. Public Counsel proposes that financial incentives should be calculated based on total electricity savings. Our proposal includes two components in the incentive calculation. The first component is a dollar per megawatt-hour (MWh) saved figure. At each specified range the Company receives a dollar amount for each MWh saved (please see Exhibit No. _____ (ECK- 3)). For example at 100% of the "stretch" target of 20 MWa the Company would receive $14/MWh.

The second component of Public Counsel's recommended incentive calculation is a "shared net incentive." The concept behind the shared net incentive is to 1) share a portion of the economic value with the Company that otherwise flows exclusively to ratepayers, and 2) create a motivation for the Company to manage its program costs (though program costs represent only a portion of total resource costs). As shown in the box at the top of Exhibit No. ____ (ECK-3), this calculation begins with the company's avoided cost per kilowatt-hour (for conservation analysis purposes) and deducts the Total Resource Cost (TRC) per kilowatt-hour of the Company's conservation programs to calculate the net shared incentive per kilowatt-hour of the conservation programs. The "net shared incentive" component of the mechanism directs a small percentage of this economic value from the first year savings to the Company.

Taken together, the total incentive payments escalate in value per megawatt-hour saved as the conservation achievement in a given year increases. This escalation in dollar incentive per average megawatt conserved is intentional. The more conservation achieved, the higher the incentive per average megawatt. The intent is to inspire the Company to keep working to capture this least cost resource on behalf of its ratepayers.

Q. What does Public Counsel propose as a penalty?

A. We propose a penalty mechanism with a dollar per megawatt-hour payment for each megawatt-hour that the Company's performance falls below 80% of the "stretch" target (20 MWa for 2007). The Company would therefore face penalties if the Company's performance fell below 16 MWa. (20 MWa x .8 = 16 MWa). As I discuss earlier in my testimony, we recognize the Company's "stretch" target is an aggressive target upon which the Company's program budget and program mix is based.

Because the 20 MWa target is an aggressive target we recommend a "dead band," down to 80% of the "stretch" target, or 16 MWa for 2007, where no penalty is paid. For example, if the Company's performance drops to 15.8 MWa, then it would pay a dollar per megawatt-hour payment for every MWh its performance falls below 20 MWa. This per MWh fee escalates as the Company's conservation performance deteriorates.

Q. What is the function of the penalty mechanism?

A. The penalty mechanism can be viewed as a type of insurance plan that protects ratepayers against such things as a change in executive or board leadership of the Company that might negatively impact the Company's emphasis on conservation programs. Given the current leadership and recent emphasis on conservation at PSE, we anticipate that it is unlikely that the Company would pay a penalty. However, the Company's pursuit of least cost resources has varied dramatically over the prior ten years, and we see a value in such an electric energy efficiency incentive-penalty mechanism in helping maintain consistency.

Q. Please explain Public Counsel's recommended penalty payments.

A. Analysis of utility conservation programs over the past several years indicates that some of the least expensive utility programs have cost at least $1 million for first year MWa savings. This translates to approximately $115 per MWh for first year savings. We have therefore selected $115 per MWh as the proposed penalty fee should the Company's conservation achievement fall below fifty percent of the "stretch" target. At this price, the Company could invest those payments with third party contractors who could capture actual megawatt-hour savings for PSE's ratepayers. As shown in the penalty section in the lower portion of Exhibit No. ____ (ECK-3), the penalties escalate in order to serve as an enhanced disincentive for the most egregious failures.

Q. Why are the incentives and penalties disproportionate?

A. The two are designed for very different purposes. The incentives are designed to reduce the disincentives to the Company to capture conservation for its power system. It is likely, based on the Company's experience over the past three years, that the Company will receive an incentive for its achievement. Of course, for 2004 and 2005 the Company had a biennial target, and achieved this target over two years. An annual target may provide new challenges given the uneven nature of conservation acquisition. The penalties serve as an insurance plan should the working culture or goals of the Company steer it away from capturing this least cost resource.

Q. Does Public Counsel propose this mechanism as a pilot with a termination date?

A. Yes. We propose a sunset of this incentive-penalty mechanism at the end of three program years. In this case the pilot would operate for 2007, 2008, and 2009. Incentives and penalties would continue to be fully paid for program performance in 2009. (Timelines for payments of incentives and penalties occur over a two-year period as outlined in Exhibit No.___ ECK - 4.) However, the mechanism will terminate at the end of 2009. The Company may file a request to extend or modify the mechanism beyond the three year pilot period, either as part of a general rate case proceeding or as part of a separate filing. This is a significant change in public policy in Washington and the burden should be on the Company to demonstrate to the Commission and its stakeholders the results of the mechanism and its achievements in conservation at the end of three years, in order to justify continuation.

Q. Are there any criteria, or requirements, that PSE should meet in order to be eligible to receive an incentive payment?

A. Yes, please see Exhibit No. ___ (ECK - 4). This exhibit, "Design Criteria for Electric Efficiency Incentive Mechanism" provides a list of requirements that are threshold issues for the Company to meet prior to being awarded incentives. These requirements reflect a joint recommendation by Public Counsel and the Commission Staff. Two particularly important criteria are the following.

First, the Company must achieve at least 75% of the projected savings in each customer sector (residential and commercial/industrial). It is important that conservation resources in one sector not be abandoned in pursuit of easier conservation in another sector.

Second, the Company must maintain a weighted average measure life for its total program portfolio that exceeds nine years. It is critical that the Company invests ratepayer funds in longer-term resources that may have more expensive first year savings, but have savings that endure for decades. Absent this requirement, the Company may choose to capture shorter term conservation resources that have lower program costs, thus losing the opportunity to capture longer-term energy efficiency resources such as new residential or commercial construction, new heating or air conditioning equipment, and new refrigerators.

Q. Would the Company set new electric efficiency targets each year?

A. The Company recommended annual conservation targets with annual incentives or penalties. While annual targets may present challenges to the Company, we are prepared to support annual targets. These targets would be established in cooperation with the Company's Conservation Resource Advisory Group, as they have in the past. Each annual target for 2007 through 2009 would then be approved by the Commission. If any stakeholder has concerns with the Company's proposed targets, they would have an opportunity to voice their concerns with the Commission.

Q. What is Public Counsel's position with regards to the demand-response pilots?

A. Public Counsel agrees with Commission Staff that the demand-response pilots should be removed from the rate case and instead be funded by the tariff rider, Schedule 120, when properly developed. Public Counsel asks that the Company work with the Conservation Resource Advisory Group to expeditiously review and refine the demand-response pilots.

Q. Does this conclude your testimony?

A. Yes, it does.