Design Criteria for Electric Efficiency Incentive Mechanism

(Jointly Supported by Public Counsel and Commission Staff)

1. If approved, the mechanism becomes effective for programs to be implemented starting January 1, 2007.

2. The Company must achieve at least 16.5 aMW in 2006 in order to be eligible for an incentive in 2007.

3. The baseline target for the incentive/penalty mechanism will be set on an annual basis, with joint consensus of PSE and the CRAG, and subject to Commission approval. Penalties or incentives shall be paid or awarded in the two following years, on the basis of annual energy efficiency achievement by the Company.

4. PSE must achieve at least 75% of the projected savings in each sector, in order to be eligible to receive an incentive. The sectors are residential and commercial/industrial. Savings attributed to self-directing industrials in Schedule 258 and the Northwest Energy Efficiency Alliance in Schedule 254 are excluded from any sector calculation.

5. The weighted average measure life of the total program portfolio must meet a minimum of 9 years to be eligible for an incentive.

6. All first-year savings from all funding sources count towards the baseline target with the exception of annual savings as calculated by the Northwest Energy Efficiency Alliance (NEEA). The company may claim its proportionate share of NEEA annual savings only from NEEA programs that are receiving implementation funding during the company's program year. For example, NEEA tracks and counts savings from its Builder Operator Certification program. These savings would not count toward the company's annual conservation target because NEEA discontinued funding for this Builder Operator program several years ago.

7. Following each program year, it will be determined if the Company qualifies for an incentive or a penalty based on PSE's Annual Report on Conservation Results, filed with the Commission on or before February 15. The Annual Report will include year-end savings and cost-effectiveness results.
   a. If a penalty is to be incurred:
      i. PSE shareholders will pay 75% of the full penalty within 90 days of filing the Annual Report. The remaining 25% of the penalty shall be paid no later than April 1 of the second year following the

program year, subject to adjustments based on the results of ex-post verification of savings by the Evaluation Committee. PSE shall provide for separate accounting of the penalty funds, with interest accrued (at the company's commission authorized overall rate of return), until the funds are released pursuant to the RFP process discussed below.

   ii. The penalty will be paid on a pre-tax basis.
   iii. The penalty will be used to fund cost-effective programs through a Request for Proposals to third-party contractors. PSE shall initiate the RFP process within one month after a payment amount becomes due (i.e. upon both the 75% and 25% penalty amounts described above in section 7(a)(i) becoming due).
   iv. PSE may seek mitigation from the Commission for under-performance due to factors beyond PSE's control, pursuant to section M, paragraph 42 in the Settlement Terms for Conservation in Docket UE-011570 and UG-011571.

b. If an incentive is to awarded:
   i. PSE will collect 75% of the full incentive in the year after programs have been implemented. The remaining 25% of the incentive will be collected the following year, subject to adjustments based on the results of ex-post verification of savings by the Evaluation Committee.
   ii. Incentives will be collected through the existing electric tariff rider (Schedule 120), with a separate tariff describing the incentive/penalty mechanism (Schedule 121).
   iii. Incentives will be paid on a pre-tax basis. PSE is responsible for taxes.

8. PSE will establish an Evaluation Committee, composed of PSE staff and 2-3 CRAG members and/or other external parties. At least one Evaluation Committee member will be from Commission Staff. This committee will develop and review evaluation plans and savings verification. Consideration will be given to use of third-party firms to conduct studies as deemed appropriate by the committee to ensure objectivity. PSE will recover all verification/evaluation costs through the electric tariff rider, Schedule 120.

9. PSE's portfolio of programs must, in aggregate, be cost-effective from both the Utility Cost and Total Resource Cost (TRC) perspectives to be eligible for an incentive. The amount of any incentive or penalty shall be excluded from the calculation of the Net Shared Incentive, but shall be included to determine overall aggregate cost-effectiveness. The Net Shared Incentive is the difference between the Company's avoided cost and the TRC value of the Company's annual program results. The TRC value will be updated annually according to actual achievement. The avoided cost will be based on the Company's most recently

filed Integrated Resource Plan (IRP). The avoided cost value may be updated between IRPs if conditions warrant and with review and agreement of the CRAG.

10. PSE must inform the CRAG if annual program expenditures are expected to fall below 80% of budget or exceed 120% of budget. (This simply reaffirms the commitment outlined in Section D.(8) of the Conservation Settlement in the 2001 rate case).

11. The incentive mechanism will sunset after 3 full program years (2007 - 2009). The Company shall complete collection of incentives or payment of penalties for all 3 program years under this mechanism. The Company may file a request to extend or modify the mechanism beyond the pilot three-year period, either as part of a general rate case or in a separate filing.

12. In calculating actual conservation achievement as a percentage of the target, numbers will be rounded to the nearest tenth of one percent.