BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Conservation Incentive Inquiry	)	DOCKET NO. U-100522
	)	COMMENTS OF THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

I. INTRODUCTION

The Industrial Customers of Northwest Utilities ("ICNU") submits the following comments to the Washington Utilities and Transportation Commission ("WUTC" or the "Commission") regarding the Commission's Consolidated List of Issues regarding Conservation Incentives. Pursuant to the Commission's direction, ICNU has organized its comments to follow the order and structure of the official list of issues. ICNU supports the continued development of cost-effective conservation resources for Washington's investor-owned utilities as they are an essential component of the utilities' least cost resource portfolio, but opposes electric decoupling because it is unnecessary to ensure that utilities acquire all cost-effective conservation resources and because it causes numerous, significant harms to ratepayers.

Decoupling is not necessary to encourage Washington utilities to invest in conservation resources. Washington's electric utilities have historically met or exceeded their proportionate share of regional conservation goals and are nationally recognized as leaders in conservation investments. The Commission should also recognize that the electric utilities' largest end-use customers have a consistent record of taking proactive and aggressive steps to

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invest in efficiency, conservation and other measures to reduce their amount of electricity consumption. There is no reason to believe that Washington will not continue to be a national leader in conservation investments, especially given the statutory mandates of the Washington conservation targets, which require utilities to acquire all cost effective, reliable and feasible conservation resources.

II. COMMENTS

1. General: Definitions

The Commission's previous orders and plain, ordinary English provide clear and easy-to-understand definitions for the terms "decoupling," "lost margins," and "fixed costs." The Commission has defined decoupling as "a ratemaking and regulatory tool that breaks the link between a utility's recovery of fixed costs and a customer's energy consumption."[1/] Margins are typically understood to mean the difference between the sales price and the cost production, and lost margins are the inability to recover part or the entire margin.[2/] Fixed costs are generally understood to include those costs which do not significantly vary depending on sales or production levels.

Decoupling works by allowing a utility to recover "part, or even all of its fixed costs regardless of reduced consumption."[3/] Thus, a utility is allowed to recover some or all of its fixed costs and/or its lost margins associated "with the impacts of its own programmatic and

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1/ WUTC v. PSE, Docket No. UE-060266, Order No. 8 at ¶ 53 (Jan. 5, 2007).

2/ See Re Washington Water Power Co., Docket Nos. UE-920351, UE-920352, UG-920353 and UG-920354, Pardini Dissent at 1 (May 5, 1992).

3/ WUTC v. PSE, Docket No. UE-060266, Order No. 8 at ¶ 53.

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non-programmatic conservation efforts."[4/] Decoupling also has the practical impact of shifting "some degree of risk from the company to its customers" because the utilities are guaranteed a certain amount of earnings and cost recovery regardless of their actual level of electricity sales.[5/]

The oft-stated goal of decoupling is to address the utilities' alleged disincentive to invest in conservation because "as consumption declines so may a company's recovery of that portion of its fixed costs embedded in volumetric rates."[6/] The purpose of decoupling is to remove these alleged financial disincentives to investing in conservation programs.[7/] Therefore, decoupling should only be allowed if there are actual (rather than theoretical) disincentives, and any decoupling programs should be narrowly tailored to remove these actual disincentives in a manner which minimizes unintended or harmful consequences to ratepayers and the utilities.

2. General: Recovery of Conservation Program Costs

The Commission asks if the utilities are able to timely recover their conservation program costs, (if not) how and why cost recovery is not timely, and whether there are other methods of funding conservation programs that would be more efficient and effective at acquiring conservation resources. ICNU understands that the utilities' current conservation tariffs and funding mechanisms are sufficiently robust and adjusted frequently enough to allow timely cost recovery. ICNU will review and may respond to any arguments that other parties make regarding the ability of the utilities to timely recover conservation program costs.

4/ WUTC v. Avista, Docket No. UE-090134, Order No. 10 at ¶¶ 290-92 (Dec. 22, 2009); see also WUTC v. PSE, Docket No. UE-060266, Order No. 8 at ¶¶ 55-56.

5/ WUTC v. Cascade Natural Gas Corp., Docket No. UE-060256, Order No. 5 ¶¶ 65, 80-81 (Jan. 12, 2007); WUTC v. Puget Sound Power & Light Co., Docket No. UE-950618, Third Suppl. Order at 6 (Sept. 21, 1995).

6/ Id. at ¶ 55.

7/ WUTC v. Avista, Docket Nos. UE-090134, UG-090135 & UG-060518, Order No. 10 at ¶¶ 290-92; WUTC v. PSE, Docket No. UE-060266, Order No. 8 at ¶¶ 53-56.

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The Commission has inquired into whether there are alternative methods of funding conservation that would be more efficient and break the alleged utility disincentive to invest in conservation. The Commission could remove the utilities from the administration of conservation programs, which has occurred in Oregon with the Energy Trust of Oregon ("ETO"). Oregon law requires that the two largest electric utilities in Oregon impose a separate public purpose tariff, a portion of which fund a non-governmental organization: the ETO. The Oregon Public Utility Commission selected the ETO to run the conservation programs and oversees its operations. Cascade Natural Gas and Northwest Natural have voluntarily agreed to use the ETO to run their conservation programs. The ETO has been successful in funding a significant amount of cost effective conservation and the utilities do not control ETO's funding sources nor do the utilities manage the actual conservation investments. Other states have taken the approach of establishing a separate organization that is responsible for conservation programs.

3. The Development of Conservation Resources Does Not Deny the Utilities an Opportunity to Earn Their Allowed Rate of Return

The potential lost margins associated with the development of conservation resources do not prevent Washington utilities from earning their allowed rate of return. The utilities have never provided quantifiable evidence that demonstrates that the amount of lost margins related to utility conservation programs has any significant impact upon the utilities' opportunity to earn their rate of return, especially in comparison to other risks the utilities are expected to manage, including loads, weather, hydro conditions and market prices. The potential that some sales may not occur because conservation resources are developed is just one of many

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risk factors associated with operating a regulated electric utility that utility executives are expected to manage.

The risk that small reductions in load attributable to utility conservation programs could impact the utilities' earnings is mitigated by the annual utility rate proceedings. All three electric utilities have been filing near annual general rate proceedings, and both Puget Sound Energy and Avista have power cost adjustment mechanisms—all of which provide the utilities with significant protection against regulatory lag and the risk that actual costs will significantly depart from the costs assumed in rates. There is no evidence that conservation programs have denied any electric utility an opportunity to earn its allowed rate of return, especially given that there have been annual reviews of the electric utilities' costs and earnings, and annual rate increases.

4. There Is Only a Small Amount of Potential Lost Margins Associated with Utility Conservation Programs

There is no empirical evidence that there are significant lost margins associated with utility conservation programs, particularly since power costs are increasing and in general the electric utilities are not in a power surplus mode. The Commission should not adopt any electric decoupling programs until it can be established that there is a significant and demonstrable amount of lost margins which are the result of incremental utility conservation programs. Any failure to directly tie a decoupling program to the specific and actual utility lost margins will be overbroad and harm ratepayers without any actual increase in the amount of utility investments in cost effective conservation programs. Electric ratepayers have been

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experiencing annual rate increases and the Commission should be very reluctant to impose decoupling related increases in these challenging economic times.

The Commission has recognized that any decoupling mechanism must "account for lost margin due to conservation, and to discriminate between the various causes of lost margin."[8/] Distinguishing between lost margins because of conservation and other factors is necessary "to avoid guaranteed recovery of lost margin that would occur should lost margin from other causes be included in the mechanism."[9/] Lost margins associated with conservation programs the utility does not control should be excluded, including independent customer conservation efforts, substitution of fuels, conservation because of building codes and other standards, Northwest Energy Efficiency Alliance ("NEEA") conservation savings that are not counted in the utility's programmatic or information efforts, and simple demand elasticity from heating fewer rooms or lowering the thermostat. Only the lost margins associated with company sponsored conservation programs should be allowed.

The Commission should further refine its analysis of lost margins, and (if decoupling is allowed) limit the recovery of lost margins to only those conservation programs that the utilities would not otherwise invest in. There is a baseline amount of conservation that even utilities that allegedly have a disincentive will invest in. In Washington, the baseline is, at a minimum, the amount of conservation the utilities are required by law to obtain. Utilities should not be allowed to benefit from a decoupling program to account for those conservation resources the utilities are already going to invest in regardless of whether there is a decoupling program.

8/ WUTC v. Avista, Docket Nos. UE-090134, UG-090135 & UG-060518, Order No. 10 at ¶ 291.

9/ Id.

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The Commission should also require proponents of decoupling programs to provide detailed, empirical evidence of the amount of lost margins and their specific causes. The Commission has stated that it is a "difficult" but not "impossible" task to determine how much of a utility's lost margins are attributable to its conservation efforts.[10/] The Commission has been critical of the lack of empirical data to evaluate the amount of lost margins caused by conservation, and that parties in Commission proceedings have provided wide ranging estimates of the number of a utility's lost margins that are attributable to conservation.[11/] Ratepayers should not be required to shoulder the risks and higher costs associated with decoupling programs if the utilities cannot provide demonstrable evidence of the exact amount of lost margins that would occur from their incremental conservation programs that would not be invested in without decoupling.

5. Direct Conservation Incentives Should Not Be Designed to Ensure that a Utility Earns a Sufficient Rate of Return

The purpose of conservation incentives is "to promote conservation of electricity through the use of direct incentives and disincentives to the Company—rewards for reaching, and penalties for failure to reach conservation targets."[12/] The sole purpose of conservation incentives should be to provide appropriate rewards and penalties to encourage the utilities to obtain a specific amount of cost effective conservation. While conservation incentive rewards and penalties should not be set so high as to prevent a utility from earning a sufficient rate of return or allow a utility to over earn, there should be no other relationship between the

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[10/] Id. at ¶ 295.
[11/] Id. at ¶ 295 n413.
[12/] WUTC v. PSE, Docket Nos. UE-060266 and UG-060267, Order No. 8 ¶ 54 (Jan. 5, 2007).

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conservation incentives and utility earnings. In other words, conservation incentives should not be used with the purpose of ensuring the utilities earn their authorized earnings.

Conservation incentives may also be a sufficient substitute for decoupling programs. Decoupling is only "one method of supporting conservation"[13/] and "is a means to an end, not an end in itself."[14/] The Commission has recognized that sufficiently robust penalties for the failure to achieve conservation goals could change a utility's behavior and lead to the conclusion that "decoupling is unnecessary to promote conservation."[15/] If there is no actual utility disincentive to invest in conservation, or if the disincentive is adequately removed through other means, then there is no reason to adopt any form of decoupling.

6. Any Lost Margins Should Be Offset By Found Margins

A decoupling program that allows the recovery lost margins should include offsets for revenues associated with new load from new customers and additional load for existing customers, including load increases that may result from new conservation programs. Standard ratemaking theory follows the matching principle, which requires that offsetting factors should be taken into account when setting rates and establishing rate mechanisms.[16/] As recognized by the Commission, certain conservation programs can actually result in increased, albeit more efficient, electricity usage.[17/] Thus, "while a conservation program may lead to reduced load on the one hand, it may stimulate customer behavior that actually increases net

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13/ WUTC v. Avista, Docket Nos. UE-090134, UG-090135 & UG-060518, Order No. 10 ¶ 309.
14/ WUTC v. PSE, Docket Nos. UE-060266 & UG-060267, Order No. 10 ¶ 65 (Jan. 5, 2007).
15/ WUTC v. Cascade Natural Gas Corp., Docket No. UG-060256, Order No. 6 ¶ 33 (Aug. 16, 2007).
16/ See WUTC v PSE, Docket Nos. UE-090704 & UG-090705, Order No. 11 ¶¶ 43, 47 (April 22, 2010).
17/ WUTC v PSE, Docket Nos. UE-090704 & UG-090705, Order No. 11 ¶ 45.

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load."[18/] From a program implementation perspective, all offsetting increases in load should be accounted for and netted out from any decoupling program.

7. Decoupling Programs Should Exclude Industrial Customers

Any decoupling program should include an exemption for industrial customers. Industrial customers are sufficiently large that any issues regarding lost margins can be individually tailored to these customers. Decoupling programs may also not be necessary for large industrial customers as their electricity costs are a significant cost of business, and these price sensitive customers typically aggressively pursue their own and their utilities' cost-effective conservation and energy efficiency programs. Finally, decoupling can have the practical effect of discouraging industrial customers from reducing their usage because they do not reap the full value of any savings associated with lower electric usage.

Decoupling for industrial customers can have a myriad of negative impacts, including potentially discouraging and penalizing customers for engaging in conservation programs. Large customer rate classes sometimes have limited numbers of customers, and a significant change in load in one or a small group of customers can dramatically impact the entire class. For example, the closure or major production change at one facility can impact the entire rate schedule. Decoupling programs often have the practical effect of imposing an after the fact charge on the remaining customers for the load loss of different customers. Thus, a smaller group of customers are required to pay for the lost revenues of the entire class. This can be especially harmful and damaging in a poor economy when the surviving customers must pay

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[18/] Id.

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even higher electricity costs to make the utility whole when loads are down, for reasons other than conservation.

Decoupling can also send inappropriate and incorrect price signals, which can discourage customer financed conservation and is harmful to large companies that need to be able to plan and budget their expected power cost expenses. Industrial customers often invest in their own conservation and energy efficiency programs, with the expectation that these investments will result in lower overall electricity costs in the future. Decoupling can be a powerful disincentive for customers to invest in their own conservation programs if the reward for reducing electricity usage is higher future rates.[19/] These and other reasons have resulted in many decoupling programs exempting industrial customers.[20/]

8. Decoupling Leads to Poor Utility Management

Decoupling programs provide a disincentive to the utilities to control their costs and improve customer satisfaction, and ultimately result in more expensive and lower quality utility services. Decoupling can theoretically remove utility disincentives, but does not provide any incentives and encourages poor management because the utilities are indifferent to whether they sell more or less electricity. The Commission should carefully weigh whether any increases in conservation investments which could potentially occur from decoupling programs are worth the costs associated with management indifference to the success or failure of their customers.

19/ WUTC v. Cascade Natural Gas Corp., Docket No. UE-060256, Order No. 5 ¶ 73; WUTC v. PSE, Docket No. UE-060266, Order No. 8 at ¶ 62.

20/ See, e.g. In re Application of Carolina Power & Light Co., Inc., Docket No. 2008-251-E, Order Approving DSM/EE Application at 9 (S.C. Pub. Serv. Comm'n 2009); Application of Oklahoma Gas and Elec. Co., Docket No. PUD 200800059, Order No. 556179, Attachment 1 at 5 (Okla. Corp. Comm'n 2008); In re Application for Recovery of Costs, Lost Margin, and Performance Incentive Associated, Docket No. 06-91-EL-UNC et al., Finding and Order at page 5 (Ohio Pub. Utils. Comm'n 2007); Re PGE, Docket No. UE 197, Order No. 09-020 at 26 (Jan. 22, 2009).

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Utilities promote decoupling not to increase conservation programs, but to protect their earnings and revenues from sales which could theoretically be related to additional conservation. The practical impact is that utility management is indifferent to the overall level of sales and the price or quality of their product, and indifferent to the success or satisfaction of their customers. The removal of the risks of lost margins because of the development of conservation programs will reduce the overall risk portfolio of the utility and encourage bad management practices. As explained by Standard & Poor's: "Decoupling's guaranteed level of distribution revenue, regardless of actual performance, may promote mediocrity in the management of a utility and cause a decline in customer service."[21/]

9. Relationship of Utility Incentives to Conservation Mandates

The Washington electric utilities have a strong history of aggressively investing in conservation resources and Washington is a national model for conservation programs, which demonstrates that decoupling is not necessary to remove any alleged disincentives for additional investments in conservation. The Commission should rely upon the traditional ratemaking process, narrowly tailored incentive programs, and the rigorous mandates of I-937's targets rather than decoupling programs that harm customers.

There does not appear to be a need for decoupling programs in Washington. The utilities have a legal mandate from I-937 to invest in all cost-effective, reliable and feasible conservation.[22/] The adoption of decoupling programs is based on the assumption that the utilities are going to ignore their legal obligations—which does not represent sound public

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21/ Standard & Poor's: Decoupling: The Vehicle for Energy Conservation? at 3 (Feb. 19, 2008).
22/ RCW § 19.825.040.

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policy. In fact, as recognized by the Commission, the Washington electric utilities currently acquire more than Washington's individual share of the Northwest Power and Conservation Council's assessment of their conservation potential.[23/] Washington is itself nationally renowned as a leader in investments in conservation and energy efficiency, including utility-sponsored conservation programs.[24/]

The "fundamental test" of decoupling "is the likelihood of increased conservation as a result of implementing a decoupling program."[25/] The legal requirement for utilities to invest in conservation, coupled with the utilities' strong history of making utility conservation investments, makes decoupling programs unnecessary because decoupling is not likely to actually result in additional conservation programs.

10. Utility Authorized Rates of Return Should Be Reduced if Decoupling Programs Are Adopted

Decoupling shifts the risk of changes in loads and sales from utility shareholders to customers, and the Commission should require that utilities' authorized rate of return be adjusted to reflect this change in their business risk profile. The existence of decoupling allows the utilities to protect their earnings in the event of reduced sales, improves the opportunity to earn their authorized return on equity, and reduces its overall operating risk. The Commission has repeatedly acknowledged that one of the main disadvantages of decoupling is that it shifts

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23/ Docket No. U-100522, Notice of Opportunity to File Written Comments (May 13, 2010).
24/ See, e.g. 2009 State Energy Efficiency Scorecard, American Council for an Energy-Efficiency Economy.
25/ WUTC v. Cascade Natural Gas Corp., Docket No. UG-060256, Order No. 6 ¶ 65.

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risks to ratepayers.[26/] Ratings agencies have similarly recognized that decoupling reduces utility risks and they view decoupling as "a positive development from a credit perspective."[27/] The adoption of any decoupling or incentive program should include a downward adjustment in the utility's rate of return to reflect the utility's lower risk profile.

III. CONCLUSION

The Commission should not utilize decoupling programs to encourage utility conservation investments. Historically, decoupling has not been needed to achieve high levels of conservation investments in Washington, and should not be needed to require the utilities to fulfill their legal obligations to acquire all feasible, reliable and cost effective conservation. Decoupling comes at a very high cost to customers by shifting risks, encouraging utility management mediocrity, providing inaccurate and cumbersome price signals, and discouraging customer-financed conservation and energy efficiency. If the Commission elects to allow decoupling programs, then they should exempt industrial customers, be narrowly tailored to only address those few clearly identifiable lost margins associated with incremental utility conservation programs and include a cost of capital adjustment in exchange for the utility's reduced risks. In addition, any incentive programs should be narrowly tailored to achieve certain conservation goals, should not guarantee the utility a specific threshold level of earnings, and should ensure that the utilities are not allowed to over earn.

26/ WUTC v. PSE, Docket No. UE-060266, Order No. 8 at ¶ 61; WUTC v. Cascade Natural Gas Corp., Docket No. UG-060256, Order No. 6 ¶¶ 76, 80; WUTC v. PacifiCorp, Docket Nos. UE-050684 & UE-050412, Order Nos. 3 & 4 ¶¶ 108-09 (April 17, 2006).

27/ Standard & Poor's: Decoupling: The Vehicle for Energy Conservation? at 3 (Feb. 19, 2008).

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Dated this 4th day of June, 2010.

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