

**BEFORE THE WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION**

<b>In the Matter of the Inquiry into</b>	)	<b>Docket No. U-100522</b>
	)	
<b>Conservation Incentives and</b>	)	<b>The Energy Project's</b>
<b>Lost Margin Recovery</b>	)	<b>Responses to the Consolidated</b>
	)	<b>Issues List</b>
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The Energy Project files the following comments in accordance with the May 13 Notice of Opportunity to File Written Comments in response to the WUTC's consolidated list of issues in Docket No. U-100522. While we have not responded to each and every question posed in that docket, we reserve the right to submit responses in future discussions on any and all questions or issues and to the responses submitted by other parties participating in the docket.

Generally speaking, while we applaud the more progressive approach some utilities have taken, Energy Project questions whether such measures as lost margin recovery or decoupling are ever sufficient to counter a private utility's interest in selling more power and the conflict that presents for aggressively sponsoring energy efficiency. We note that the difficulty in finding the proper balance between the reward that is sufficient from the utility's perspective and what constitutes over compensation is formidable. The workings of such mechanisms are complex and ripe for gaming. Done poorly, they unjustly and unnecessarily burden consumers with additional costs, in particular low-income customers. Ultimately, we believe a third party whose complete focus is on sponsoring energy efficiency, reducing consumption, and reducing greenhouse gases best serves conservation.

**Amended Consolidated Issues List**

**General**

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

The Energy Project prefers to take a rather simple view of these concepts. We think it is important that ratepayers understand whether there are benefits for them. Decoupling as a ratemaking mechanism has been used for at least two separate purposes – to moderate the volatility caused by the differences between the expected weather when rates are determined and the actual weather that determines how much revenue is ultimately collected. That, however, is not the application this docket is focused on. Rather, that decoupling is the idea that a mechanism can successfully remove a utility's disincentive to promote real conservation savings by restoring to them some of the revenue they lost

when customers conserved. Simple enough conceptually, but unfortunately much trickier when it comes to determining how to make it work without resulting in a number of unintended effects. From the simplest perspective the “lost margin” refers to that portion of the price of a unit of energy that is not due to the commodity cost. There are significant differences, however, about what constitutes a cost included in that portion of the bill that is truly “fixed”. Added to that difficult determination is whether the margin is in fact “lost.” Since the price of a kilowatt or therm is determined going forward by spreading the revenue requirement across the expected sales, based on a number of assumptions/estimations such a “normal” weather, number of customers, economic growth, etc., it is incorrect automatically to assume that a utility does not adequately recover the revenue they need because they do not collect that portion of a kilowatt or therm saved. Actual consumption is determined by many other factors that we suspect have profoundly more impact on the utility’s revenue recovery.

- 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.*

Yes, we believe utilities have the opportunity to recover costs in a timely manner. If we recollect correctly, utilities originally capitalized their conservation investment, but chose to shift to expensing them in order to get more timely recovery. That shift coupled with the fact that the time period between rate cases had decreased considerably argues the recovery is timely.

- b. *Are there other methods of funding conservation programs that would be more efficient and effective at acquiring conservation resources?*

In our opinion the crux of the discussion centers on the conflict of interest from having a company that makes its profit or increases its share value by selling a product also responsible for encouraging people to use less of that product. The only clear way to remove that conflict of interest is to separate those two responsibilities. Programs in Vermont, Wisconsin and Oregon that have removed the conservation responsibility to a third party whose reason for being it to promote conservation appear to be quite successful. We support a rigorous study of the pros and cons of these options, such as the Energy Trust of Oregon, Efficiency Vermont, California’s third party non-utility administrators, and other such examples domestically and abroad.

### **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? Would an attrition study be the best way to determine this question? Are there alternative ways of making such a determination?*

The development of conservation resources does not automatically deny the utility an opportunity to earn their allowed rate of return. Too many other factors contribute to whether the utility captures what is allowed, including influences that have a much greater magnitude than the energy conservation they promote. If the energy conservation option is the cheapest resource acquisition in the marketplace, why isn't a fair rate of return whatever the Commission deems with testimony from all parties? That is, historically it has been the ratepayers taking the risk from thermal plants, and the companies making a fair rate of return on those acquisitions, which were more expensive options than conservation. Conservation was not considered on a level playing field with generation. Now that the NWPC has made that so, we don't feel that this investment, which benefits the company, the ratepayers, and the taxpayers (from a carbon perspective), should be treated differently regarding rate of return. If the "fair" rate of return is lower than historically has been the case from generation expenses, so be it.

- 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?*

We are not aware of analysis that provides the comparative risk evaluation the second question requests, but think it is important to make the comparison.

- 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 questions 14-17 below relating to conservation mandates.) Is it to ensure that the utility earns a sufficient rate of return? Does an incentive program act as an effective substitute for decoupling?*

One can certainly wonder why ratepayers should pay an incentive if least cost planning is truly being practiced and I-937's requirement to capture all cost effective conservation is being enforced. That said, the inherent conflict of interest in the current system encourages one to try to come up with mechanisms to support implementation of energy efficiency. Paying an incentive is simply positive reinforcement to encourage the behavior that you want on the part of the utility; we do not believe it is to ensure utility earnings. We do not see paying an incentive as the same as removing a disincentive, or penalizing failure. We believe behavioral psychologists would argue that positive reinforcement is a stronger motivator than simply removing obstacles

to the “good” behavior one wants. Asking whether it is an effective substitute for decoupling assumes that decoupling works, which we question. The more apropos question might be whether an incentive is as attractive as decoupling/lost margin recovery to utilities and why not? Generally speaking the answer seems to be in the difference between the sizes of the cash flows from ratepayers to the company. That said, we think there is merit in a relative amount of symmetry.

### **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).*

In general we do not believe any of these items should be categorically subject to recovery on the basis that the utility is not making their allowed rate of return, in isolation of the other factors that affect achieving the needed revenue requirement. Once past that, the difficulty is trying to isolate exactly what consumption reduction the utility should earn a lost margin on and to what extent they are responsible for the reduction. This is the most easily approached through a third party analysis of “a)” and perhaps “c).” It is particularly problematic for “b)” and “e).” We oppose the notion that the utility should get any recovery due to “f. Elasticity” for two reasons: 1) this one of the primary risks we pay them to take and 2) the examples cited in too many cases

constitute deprivation which often leads to more serious problems for the customer. We do not think the utility should receive any recovery for “d.” In fact, we believe doing so reduces the motivation for independent customer conservation.

- 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?*

Lost margin recovery may reduce a utilities resistance to sponsoring conservation, but that does not necessarily remove the incentive to promote more energy use. Removing a disincentive to energy efficiency is a different animal from and we suspect far easier than removing their incentive to promote energy use. So long as the utility sees investment in building generation resources and infrastructure as the road to profit or increasing share value, there will be a motivation to promote use. Heat pumps might serve as a good example since they are sometimes promoted for the savings benefits during heating in the shoulder months, yet will increase consumption when used unnecessarily for cooling.

- 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?*

”Found” margins should offset claimed lost margins. This again requires careful analysis to determine just what part of the new customer revenue is “above cost,” as it were. We are also reminded of a utility request a few years back for a decoupling mechanism from conservation, when the kilowatts saved could then be sold off the system for more than the embedded cost of the energy that was saved. Where does the profit from such a sale get accounted for?

- 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.*

We see no justification for excluding any class of customers. If they see benefit from conservation, and all do, then we believe they should be included in any allowed revenue recovery plan based on conservation. It may be that the structure of the mechanism is somewhat different, but the involvement should be proportional to the impact of their conservation contribution to the supposed lost margins and the benefit that accrues to them from conservation

in general.

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

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

Any allowed recovery should be performance-based and proportional to the conservation that occurs as a result of the utility's actions.

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

Since there is at least some controversy regarding how the I-937 targets have been calculated, we suggest that the higher of either the utility's current IRP or their I-937 be the lowest point around which incentives or penalties are based. That is not to say that target is the proper point at which a utility should earn an incentive. Incentives should promote performance beyond the utility's "fair share." We believe it is appropriate to have some symmetry with respect to when penalties and incentives kick in.

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

We believe penalties are appropriate and do not support an incentive mechanism without a corresponding penalty. We do not support a reward for achieving only a partial percentage of the target.

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

We believe there should be. However, we recognize that the spirit of paying an incentive to encourage excellent performance feels somewhat different in this regard from over earning in the case of decoupling or lost margin recovery. Again, it comes back to having confidence that targets are not intentionally set low in order to earn an incentive. If the point for any of these mechanisms is to ensure the sponsorship of energy efficiency doesn't deny the utility what it needs for full revenue recovery, there needs to be an over earnings test. How does that occur without a full general rate case? If one needs a full general rate case anyway, how useful is the mechanism?

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

Yes

### **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?

The most direct way would be to parallel the allocation costs of conservation across rate classes. If the point is to encourage energy conservation, the idea that those who use the most energy pay the most for the incentive has some attractiveness,

- 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?*

The Energy Project contends that is essential that the design of an incentive mechanism consider the impact on low-income customers. The basic situation is that low-income customers pay to support the utility conservation programs just as any other customer does, but are less likely to benefit from the program offerings. Three major factors contribute to the lower accessibility for low-income households.

First, programs directed to the non low-income residential customer depend on a substantial contribution from those customers. Utilities traditionally have been oriented to get the most savings for the least amount of ratepayer funds, and so try to hit the lowest price point that will pull in the customer contribution and uptake of the measure. In the recent Avista decouple evaluation, one of the changes that drove up their investment in their non low-income or "regular" residential programs was increasing the incentive paid for certain measures from 30% to 50% of the avoided cost. At that rate, the customer still must come up with the other 50%. This requires discretionary funds low-income customers do not have.

Accessibility to energy efficiency for low-income households is driven by the size of the budget of utility and federal dollars. That is, because Washington's programs are not

needs based (i.e., anyone who is income eligible can get weatherized), it is a first come first serve situation. A very small percentage of eligible households are able to access efficiency programs . . . . and their turn may be years and years away, yet they help pay for conservation in general and other low-income retrofits. One way to fix that situation is to not have low-income households pay for conservation or low-income assistance.

The mix of program offerings also has significant impact on whether low-income customers can access energy efficiency. Appliance rebate programs will seldom have much impact for low-income customers as a whole. Approximately 65% of low-income customers are renters. They are less likely to be purchasing clothes washers or refrigerators, let alone new ones. The case is the same for water heater or furnace rebates. Only the lowest cost measures would likely result in uptake paid for by the household, for example, CFLs; but then the beneficial impact is going to be pretty small on an individual basis and most likely for the low-income population as a whole.

Finally, the comparatively higher cost to achieve significant savings ultimately means that only a very small percent of low-income households get to participate in the programs that are targeted to them. That is, a program designed to accomplish a significant reduction in the low-income household bill will need to go after deeper conservation – typically building shell measures. These measures cost more in and of themselves, but also cost more because our utilities have recognized that they may need to pay up to the full avoided cost of the measure to get it installed in a low-income home. This conflicts with the utility's natural inclination to get the savings at the least cost for the ratepayers' contribution. If I-937 targets actually require utilities to be more aggressive about achieving energy efficiency, the sensitivity to rate increases on the part of utilities and other parties will only exacerbate this conflict. The cost differential is further compounded by the higher need for complementary repair dollars to go with the energy efficiency investment.

Exactly how lost margin recovery or energy efficiency funding is levied on the customer may make a difference in terms of the impact on low-income. On the one hand, it may seem equitable that a low-income household pays the same as any other residential customer, e.g., mechanism/programs costs spread on an equal dollar per customer basis. The fact that a low-income household has generally lower consumption than regular residential households, because they live in smaller dwellings on the whole and have fewer toys to play with, might suggest that levying the cost on a volumetric basis might be more fair. The Energy Project is inclined to think the difference is less important than another factor. When one considers the fact that the portion of household income a low-income family has to contribute to cover their energy costs is approximately four times what the average customer has to use, paying the same, or even a little less, for energy



conservation or lost margin recovery is not equitable, but a much more severe burden on the low-income family.

A look at the historical record will show that for many years utilities did not fund low-income programs or that the predominance of funds was spent on commercial/industrial conservation. All the while low-income customers paid for the conservation in rates, as did everyone else. More recently, the Avista decoupling pilot revealed a big increase in residential conservation funding, but comparatively little for the low-income program. At the same time, low-income households live in the worst housing stock, often with risky health or safety conditions, pay more per square foot of living space for heat, have less efficient appliances, and less comfort.

In summary:

- Yes, the design of an incentive mechanism should consider its impact on low-income customers.
- Yes, a lost margin recovery mechanism is likely to push more of the cost on to low income customers, partly because
- Few low-income customers are able to benefit from utility energy efficiency program because of the high cost of the program that can significantly impact a household bill or the inaccessible nature of the non low-income measure offerings.
- No, the relationship between bill impacts and access to programs for low-income is not 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?*

The Energy Project can see how lost margin recovery might lead a utility to be less rigorous about controlling costs, depending what the recovery is based on and how it is calculated. The question regarding PGAs (and we assume by extension PCAs) and question "10f." simply point out for us that a mechanism that considers all it should quickly approaches the level of consideration that can only be sorted out effectively in a general rate case.

### **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?*

In the spirit of offering as much carrot as stick, we think providing incentives are appropriate. In a more practical sense, the threat of penalties inherent in I-937 ironically encourage a utility to be conservative about the targets they can achieve, despite the Power Council methodology being used as a standard. Finally, we will note that the utility 2-year targets do not necessarily comprise one-fifth of their 10-year targets, yet analysis done a few years ago in the PSE conservation advisory group demonstrated that accelerated adoption of energy efficiency results in significantly more energy conservation being achieved over the whole period. This suggests incentives could have a role in encouraging utilities to go beyond their target levels.

- 14.5) *State greenhouse gas emission reduction goal (70.235.020). How would removing the linkage between the number of kilowatt hours sold and financial returns for utilities impact the state's ability to meet its statutory greenhouse (GHG) emission reduction limits (RCW 70.235.020)?*

Since there is nothing that currently makes the dirtiest resources the most expensive resources from a utility's perspective, we are not confident that reducing the link between sales and financial returns necessarily rolls back the greenhouse gas contribution of the embedded coal resources. As we understand it, unless existing coal is taken out of the system, we can't return to the 1990 levels, let alone 25% below those levels. Until the economic cost of the greenhouse gas contribution from the embedded resources are taken into the accounting, breaking this link will at best slow or, perhaps, stop the increase in greenhouse gases being contributed by substituting energy efficiency for new gas or new coal. While that is important it doesn't get us to the goal.

- 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?*

Because I-937 conceptually requires utilities to pursue "all cost-effective conservation," it is easy to jump to the conclusion that anything beyond meeting their I-937 target is not cost-effective. This is overly simplistic for a couple of reasons: 1) Nearly everything in the current 6<sup>th</sup> Power Plan was not in the last plan. We are repeatedly finding "new," very cost-effective measures that we didn't identify previously. 2) The difference between the technical potential for conservation and what is ultimately determined as "achievable" could substantially underestimate what is truly achievable.

- 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?*

First, we don't know that the first statement is actually accurate. Second, exceeding the Power Council's proportionate share may not reflect so much on the lack of disincentive as the conservative estimate of what is "achievable." Third, even if that is happening, it is in the utility customers' best interests to do so for a myriad of reasons.

- 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?*

Yes

### **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?*

Not in and of itself. It may show a general trend that might be influenced by many other factors aside from conservation. Or it may be misleading – a change in an average use/customer of 1000 therms might result from two customers saving 500 therms and eight more saving nothing or it could indicate a 100 therm/customer reduction across the board. It may thus mask inequities within a given rate class.

- 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?*

No response.

- 20) *Methods for EM&V. Should the Commission establish a method, or general guidelines for an evaluation, measurement and verification (EM&V) methodology?*
- a) *What role should a third party evaluator of EM&V play?*
  - 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?*
  - c) *What role should the Regional Technical Forum play in EM&V issues?*

We believe it would be good to standardize what is expected from the process for EM&V and

that the ultimate examination of a specific utility's programs should be done by a third party. In so far as the deemed savings estimates from the Regional Technical Forum are used in the conservation program design, we believe it is essential that they be engaged in the discussion.

- 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?*

It seems to the Energy Project that these costs are to be collected, either through a general rate case accounting or perhaps through lost margin recovery. In either case, it isn't an added cost. We believe that adding the recovery of lost margin to the cost of conservation as resource is improper because it unnecessarily and unfairly biases the analysis in favor of supply resources in terms of cost-effectiveness as well. We believe their inclusion would substantially reduce the amount of conservation that was determined to be cost-effective.

### **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?*

The utility's return on equity should reflect the risk the utility undertakes; if an incentive or lost margin recovery lowers that risk, the ROE should lower commensurately.

- 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?

If a utility needs to borrow capital in order to build supply to serve its ratepayers, they earn a rate of return on that investment, even though ratepayers ultimately pay the bill. If the conservation program is capitalized, we see no difference. If the utility chooses to expense the cost of the conservation programs and collects the costs through a tariff, they are not lending their capital to the enterprise. In such a case, they should not earn a rate of return on the program. It is difficult to say whether either scenario is superior – one

that offers a return on investment, while the other offers the security of more immediate cost recovery. Utilities have experience with each approach. While we might understand why they would like to have both benefits, we do not believe that is appropriate.

**Other Issues**

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

No response at this time.