

June 4, 2010

**Via Electronic Mail – [records@utc.wa.gov](mailto:records@utc.wa.gov)**

Washington Utilities and Transportation Commission  
1300 S. Evergreen Park Drive SW  
P.O. Box 47250  
Olympia, WA 98504-7250

Re: U-100522

Dear Sir or Madam:

Attached please find Cost Management Service Inc.'s responses regarding the 24 issues posed by the Commission in its notice of May 13, 2010, in Docket No. U-100522.

Very truly yours,

Davis Wright Tremaine LLP



John Cameron

JC:mq  
Attachment

cc: Client

Date: June 4, 2010  
WUTC Docket Number: U-100522  
Commenting Party's Name: Cost Management Services, Inc.  
Title of Document: **Comments on Issues Posed in the Commission's Notice of May 13, 2010**

Cost Management Services, Inc. ("CMS"), an independent marketer of natural gas throughout Washington and Oregon, addresses selected issues raised in the May 13 Notice, as those issues pertain to the Commission's regulation of jurisdictional gas companies.

### Overview

CMS is struck by the Commission's choice of issues, nearly all of which grapple—directly or indirectly—with the conflict of interest inherent in the regulatory *status quo* in Washington: Ratepayer-provided funds are entrusted to regulated energy companies with the regulatory expectation that these sellers will use cost-effective conservation measures to reduce their own sales volumes, while those sellers simultaneously attempt to meet shareholder expectations by maximizing profits that are largely dependent on sales. The tenor of the issues suggests that the Commission is struggling for some grand ratemaking solution, like decoupling, in the hope that this conflict of interest might be neutralized, thereby allowing regulated energy companies to both maximize conservation and maximize profits. If such a grand solution is possible at all, concrete results would have to await resolution of multiple ratemaking issues through multiple general rate cases.

Surprisingly, there appears to be very little regulatory oversight or accountability in the current system. The Commission's role appears to be limited to ratemaking – setting the ever increasing amount of ratepayer-contributed funds to be devoted to conservation. How that money is used is another matter. For example, the contracts, or even forms of contract, by which these ratepayer contributions are awarded in grants to customers are not filed with the Commission pursuant to WAC 480-80-143(1)(b), which should apply unless the Commission believes that utility-provided conservation service is not a "utility service" under the rule.

CMS urges the Commission, instead, to take immediate action to eliminate the conflict of interest by transferring responsibility for conservation programs to an independent, separately accountable organization. The prototype is Oregon, where the bulk of utility-related energy conservation programs and measures are the responsibility of the Energy Trust of Oregon ("ETO"). In fact, this division of responsibility already affects several of the Washington energy companies regulated by this Commission – those that also sell energy in Oregon. Pacific Power has done so pursuant to ORS 757.612, the statutory electric restructuring mandate that also established "public purpose" funding for energy conservation in Oregon and removed responsibility for conservation programs from utilities to the Oregon Public Utility Commission ("OPUC"), and through it, to a non-governmental organization of OPUC's choosing.<sup>1</sup> Lest the

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<sup>1</sup> Significantly, ETO is never mentioned in the statute. It is solely the contractual creation of the OPUC, established to assist OPUC in transferring conservation responsibilities from the state's investor-owned utilities to a non-profit, nongovernmental organization.

Commission conclude that a change in Washington law must precede any parallel in this state, we note that both Northwest Natural Gas and Cascade Natural Gas have transferred their respective conservation responsibilities to ETO, not pursuant to statute, but instead pursuant solely to a rate case stipulation approved by the OPUC. *E.g., Northwest Natural Gas Company*, Order No. 02-634, OPUC Docket No. UG-143 (September 12, 2002). It is our understanding that, as of October 2009, Northwest Natural is also using ETO for conservation programs relating to its customers in Washington State. Thus, it appears that the question of legal authority has already been resolved.<sup>2</sup> Utility separation from conservation-program administration is happening now in Washington, albeit on a piecemeal basis.

CMS believes that the natural gas industry presents the Commission with the opportunity for a relatively easy solution. Unlike the situation of electric utilities, there are no rate-base gas supplies. All gas is purchased from third-party suppliers for resale, at cost with no mark-up, to end users. If gas rates are properly structured, declining volumes do not necessarily mean declining utility profits. Conservation-related conflicts of interest should also be easier to resolve for gas companies because they do not face the mandates found in the Energy Independence Act ("I-937), which might legally complicate the attempted transfer of responsibility from an investor-owned electric utility to an independent third party.

Transfer conservation responsibilities from Washington gas companies to an independent third party should be comparatively simple. Northwest Natural has already done so. Cascade has already done so in Oregon. Only the gas divisions of Avista (which also operates in Oregon) and Puget Sound Energy needs to be initiated to this change. In any such transformation, CMS believes it advisable for the Commission to insist on privity of contract with the independent third party, either as a contract signatory or as a designated third-party beneficiary. It seems vital that the Commission have contractually enforceable rights against the independent third party as it actively implements ratepayer-funded conservation programs.<sup>3</sup> In Oregon, the rights and responsibilities of both OPUC and ETO are set forth in a 22-page agreement, which includes termination rights and dispute-resolution procedures. Without such a contractual link, the Commission would be left to try to influence actions of the third party through its regulated gas companies, acting as intermediaries.

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<sup>2</sup> RCW 80.01.040(4) is sufficiently broad in scope to allow the Commission to entrust to an independent third party the stewardship responsibility for funds collected from ratepayers by energy companies for the purpose of implementing cost-effective conservation.

<sup>3</sup> RCW 80.01.040(4) is also broad enough to cover regulation via contract, as OPUC does regarding ETO. Examples of regulation through contract include the Site Certification Agreements, signed by the Washington Governor and the owners of energy projects reviewed by the Energy Facility Site Evaluation Council under RCW Chapter 80.50.

**Comments Regarding Specific Issues Raised by the Commission**

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

No response.

- 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?

**Response:** CMS does not believe this to be a valid concern. Conservation funding comes from ratepayers, not from shareholders. The key question is whether ratepayers are getting optimal value for their money under a system whereby utilities and gas companies compete against themselves by undertaking both conservation-program management and energy sales.

- 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?

**Response:** To the extent utilities have made it a practice to file annual rate cases, use of a new test year should obviate the need for any attrition study or allowance. Each successive test year should be based on then-current sales volumes. To the extent those volumes have declined due to conservation measures, the Commission will be able to decide anew how the regulated entity is to be permitted the opportunity to earn its allowed rate of return.

- 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:** CMS questions the extent to which the Commission should protect energy companies against business risks associated with the more intelligent usage of energy. If Washington state were to increase the tax on gasoline and consumers responded by purchasing more energy efficient vehicles, should the state then ensure that auto manufacturers earn their full profit margin on cars with the lowest gas-mileage ratings?

- 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?

**Response:** CMS does not believe that utilities should retain responsibility for acquiring conservation resources. That responsibility should pass to an independent third party. Currently, utilities have two businesses. They sell energy and they also use ratepayer money to implement conservation measures that have the natural consequence of cutting their energy sales volumes. These two businesses are inherently contradictory. The idea of providing utilities with a financial incentive to undercutting their own sales volumes does not remove the contradiction; it only makes that contradiction more bureaucratically encumbered.

- 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:** It is our understanding that there are decoupling and energy conservation pilot programs in place in Washington. Rather than pursue this issue as a generic

matter now, it seems better for the Commission to await the outcome of those experiments. Meanwhile, there is no reason for the Commission to delay in transferring conservation responsibilities from jurisdictional gas companies to an independent third party.

Beyond that, the issue seems to poise a set of imponderable questions. Absent recurrent ratepayer surveys, exactly how would one determine whether a conservation response by a consumer was motivated by "information provided by the utility to the customer, such as educational programs" or by some unrelated activity undertaken by NEEA? The Commission might wish to add to the foregoing list the conservation effects of more energy-efficient building codes adopted by the State Building Code Council.

- 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?

**Response:** This issue is another attempt to grapple with the conflict of interest facing utilities that retain responsibility for conservation programs. CMS would end this conflict by transferring responsibility to an independent third party. Beyond that, the Commission surely has authority to prohibit utility marketing campaigns designed to promote 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?

**Response:** To the extent conservation efforts free up capacity in gas mains and other gas company infrastructure, it stands to reason that this capacity may be used to transport gas for new customers and for the additional loads of existing customers.

- 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:** Large gas customers have every incentive to economize on their energy costs. They do so in two ways. First, most of them source their own gas supplies in competitive markets, using the local gas company only for transportation service. Second, they take every opportunity to reduce their gas consumption through cost-effective conservation and efficiency measures. Savings in purchase price extend only as long as their current gas purchase agreement, whereas conservation and efficiency savings endure for the life of their commercial facility. Unlike regulated gas companies, large end-users face no conflict of interest in pursuing conservation because natural gas is strictly a cost center, not a profit center.

CMS believes that large customers should not be included in utility sponsored conservation programs. These customers have all the incentive they need to develop cost-effective conservation and efficiency measures for their businesses. Moreover, as we commented earlier in our proposed statement of issues in this proceeding, the Commission should do nothing that would inhibit access to competitive gas markets by large customers that choose to use their local gas company only for transportation service. To remain competitive employers in Washington, these large customers need to pursue every opportunity to control their natural-gas costs.

- 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?
  - b) For electric utilities, should the incentive targets be different and greater than the Energy Independence Act (EIA or I-937) targets?
  - c) Should there be penalties for failing to achieve the incentive mechanism's target or rewards for achieving only a percentage of the target?
  - 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?
  - 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.

**Response:** As explained in other responses, CMS disagrees fundamentally with the

concept of fashioning financial incentives to promote conservation by regulated energy companies. *See* response on Issue No. 5.

- 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:** See response on Issue No. 10. Specifically regarding transport customers, see response on Issue No. 9.

- 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?

**Response:** If responsibility for conservation is transferred to an independent third party, then the issue about utility incentives disappears and, with it, the risk of adverse impact on low-income customers.

- 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?

**Response:** Utilities should always be working to reduce controllable costs. The recovery of lost margin due to conservation, assuming it exists, should not influence these cost-control efforts. Moreover, gas costs are a pass through item and, as such, they are not affected by a decline in sales volume.

- 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?

No response. Issue relates only to electric utilities affected by I-937.



- 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?

No response. Issue relates only to electric utilities affected by I-937.

- 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?

No response. Issue relates only to electric utilities.

- 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?

**Response:** Put differently, this issue suggests that WAC 480-90-238(2)(a)-(b) obligates gas companies to reduce their own sales volumes and thereby their profits. CMS believes that the Commission should resolve this dilemma by entrusting the acquisition of cost-effective conservation to an independent third party, leaving the regulated gas company with the sole responsibility to acquire gas supplies at prices, and on terms and conditions, consistent with IRP goals.

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

**Response:** Certainly not among large customers whose businesses and related energy consumption vary markedly.

- 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:** If utilities continue to file annual rate increases, load-forecasting becomes easier. *See also* response regarding Issue No. 3.

- 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?

**Response:** CMS invites the Commission's attention to the Grant Agreement between ETO and the OPUC, dated December 1, 2005, in particular Article 2 ("Obligations of the Energy Trust"), Article 3 ("Accounting and Oversight"), and Article 5 ("Guidelines"). Available on-line at:  
[http://energytrust.org/About/PDF/grant\\_agreement.pdf](http://energytrust.org/About/PDF/grant_agreement.pdf)

- 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?

No response.

- 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?

**Response:** If the Commission were to insulate gas companies against more and more business risks, those companies' allowed returns on equity should tend to approach the rates of return expected by a bond holder.

- 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?

**Response:** CMS does not believe that utilities should sponsor or administer conservation programs or receive premium rates of return in return for doing so.

The question about allowing a utility earn a return on monies collected from

ratepayers to fund its conservation programs, is curious. The question answers itself; this is money from ratepayers, not shareholders. To answer this question in the affirmative leads to parallel questions about allowing utility returns on purchased gas amounts and on customer contributions in aid of construction.

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

No additional response.