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January 30, 2015

Via Electronic Mail and Federal Express

Public Utility Commission of Oregon
Attn: Filing Center
3930 Fairview Industrial Dr. SE
P.O. Box 1088
Salem OR 97308-1088

Re: In the Matter of PUBLIC UTILITY COMMISSION OF OREGON
Investigation into Treatment of Pension Costs in Utility Rates
Docket No. UM 1633

Dear Filing Center:

Enclosed for filing in the above-captioned proceeding, please find the Prehearing Memorandum of the Industrial Customers of Northwest Utilities and the Northwest Industrial Gas Users.

Thank you for your assistance. If you have any questions, please do not hesitate to contact our office.

Sincerely,



Hannah A. Adams

Enclosures

cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the attached **Prehearing Memorandum of ICNU and NWIGU** upon all parties in this proceeding, as shown below, by causing a copy to be sent via electronic mail.

Dated at Portland, Oregon, this 30th day of January, 2015.

Sincerely,



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**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1633

In the Matter of)	
)	
PUBLIC UTILITY COMMISSION OF)	PREHEARING MEMORANDUM OF
OREGON)	THE INDUSTRIAL CUSTOMERS OF
)	NORTHWEST UTILITIES AND THE
Investigation into Treatment of Pension Costs)	NORTHWEST INDUSTRIAL GAS
in Utility Rates.)	USERS
_____)	

I. INTRODUCTION

Pursuant to the Oregon Public Utility Commission’s (“Commission”) prehearing conference order in this docket, the Industrial Customers of Northwest Utilities and the Northwest Industrial Gas Users (collectively, “ICNU/NWIGU”) jointly submit this prehearing memorandum.

The Commission has a long-standing policy of allowing a utility’s pension costs to be recovered from customers in rates based on Financial Accounting Standard 87 (“FAS 87”). The evidence in this case does not warrant a change. The utilities, which have been operating for many years with fair and reasonable rates under the current policy, have not demonstrated that earning a return on their “prepaid pension assets” is now necessary to meet the statutory standard. Indeed, such a change does not recognize the long-term effects of pension cost recovery under FAS 87 in which any over- or under-funding of the plan relative to FAS 87 balances out over time. A change in policy now would, thus, be asymmetrical and inequitable to customers. Furthermore, even if the Commission determines that allowing a return on a utility’s prepaid pension asset is warranted, the utility must surmount significant, potentially impossible,

evidentiary burdens to show that its investors contributed to this asset, such that a return is warranted, and that these contributions were prudent at the time they were made, sometimes decades ago.

The Commission's current policy has worked well in the past and continues to work today. It will, over the life of a pension plan, ensure full recovery of a utility's pension costs. The utilities in this docket have not shown that any more is necessary to ensure just and reasonable rates. Accordingly, the Commission should reaffirm in this docket its policy of allowing utilities to collect their FAS 87 expense in rates and nothing more.

II. BACKGROUND

This investigatory docket was opened following Northwest Natural Gas Company's ("NW Natural") 2012 general rate case.^{1/} In that case, NW Natural requested permission to place its "prepaid pension asset" in rate base to earn a return on the balance.^{2/} The Commission rejected the utility's request, noting that it was "not yet convinced that a change to the Commission's existing policy is warranted," but established this investigation "to review the treatment of pension expense in a general, non-utility-specific basis."^{3/}

With the exception of Idaho Power, all of the major electric and gas utilities the Commission regulates – Portland General Electric ("PGE"), PacifiCorp, NW Natural, Avista Corp. ("Avista"), and Cascade Natural Gas ("Cascade") (collectively, the "Joint Utilities") – have prepaid pension assets of various sizes, and the Commission's decision in this case will

^{1/} Docket No. UG 221.

^{2/} Docket No. UG 221, Order No. 12-437 at 18 (Nov. 16, 2012).

^{3/} Id. at 22.

have a material impact on the costs these utilities (potentially including Idaho Power) can pass on to their customers.

A. Background on Pension Accounting

All of the Joint Utilities recover their pension expense from customers in rates based on FAS 87.^{4/} FAS 87 is an accrual method of accounting that represents the cost of funding retirement benefits under a pension plan as those benefits are earned by the employee.^{5/} To calculate the cost of funding the pension plan under this accrual method of accounting, FAS 87 requires a company to make a number of assumptions about the funding components of the plan, including service cost, interest cost, expected return on assets, and amortization of unrecognized costs.^{6/} Over the life of the plan, FAS 87 expense, in combination with FAS 88, will equal the total costs of the pension plan.^{7/} Accordingly, recovery of FAS 87 expense in rates provides the Joint Utilities with full recovery of their pension costs over time.

Prior to the end of the pension plan, however, FAS 87 expense may not (and likely will not) equal total funding amounts in the plan in any given year.^{8/} When the total funding of a pension plan is less than the utility has collected through FAS 87 expense, an “accrued pension liability” exists.^{9/} On the other hand, when the total funding of the pension plan is more than the utility has collected through FAS 87 expense, a “prepaid pension asset” is

^{4/} In Oregon, Idaho Power also recovers pension expense in rates based on FAS 87, but uses a cash method of accounting in Idaho. Idaho Power/100 at 5:14-20.

^{5/} Joint Testimony/200 at 4:2-6.

^{6/} Id. at 4:7-5:2.

^{7/} Id. at 11:19-12:2. FAS 88 accelerates recognition of unrecognized costs whenever there is a material change to the pension plan that results in costs being recognized earlier than they otherwise would have. Id. at 5:8-9:19.

^{8/} Joint Testimony/100 at 9:3-7.

^{9/} Joint Testimony/200 at 4:15-17.

created.^{10/} There is nothing unusual about the existence of an accrued pension liability or prepaid pension asset under FAS 87.^{11/} Indeed, they are inherent to the accounting method. Nor is the source of a prepaid pension asset or accrued pension liability transparent. The existence of a prepaid pension asset, for instance, does not necessarily represent an amount the utility has contributed to the pension plan above customer payments under FAS 87.^{12/} Utility contributions to the plan independent of FAS 87 can be one factor, as the Joint Utilities have stated,^{13/} but other factors exist as well, including higher-than-anticipated market returns.^{14/}

The existence of a prepaid pension asset or accrued pension liability, therefore, does not, by itself, demonstrate that a new ratemaking treatment for pension costs is necessary. It simply denotes a temporary accounting difference between the current funded level of the pension plan relative to the cumulative amount of FAS 87 expense collected.^{15/} This temporary difference fluctuates constantly and, again, over the life of the plan, will disappear entirely.^{16/}

B. The Joint Utilities' Request

Despite the fact that the existence of a prepaid pension asset is likely the result of a number of different factors, the Joint Utilities have alleged in this docket that their prepaid pension assets are wholly comprised of investor funds.^{17/} Accordingly, the Joint Utilities argue that they are incurring financing costs associated with these prepaid pension assets that

^{10/} Id. at 4:12-15.

^{11/} Staff/300 at 4:10-11.

^{12/} NWIGU-ICNU/100 at 17:6-11.

^{13/} Joint Testimony/100 at 10:6-10.

^{14/} Staff/100 at 18:10-19.

^{15/} Joint Testimony/100 at 7:12-15.

^{16/} Joint Testimony/200 at 11:19-20.

^{17/} Joint Testimony/100 at 10:6-10.

ratepayers must reimburse.^{18/} The Joint Utilities do not allege that the incurrence of financing costs represents a change in circumstances. Rather, it is the amount of the financing costs that has triggered their request for recovery.^{19/} The Joint Utilities argue that their prepaid pension assets have increased substantially since 2008 due to the Pension Protection Act, which accelerated federal funding requirements, and the market downturn.^{20/} Accordingly, the Joint Utilities state that the size of their prepaid pension assets are now large enough to make “pension cost recovery ... no longer fair or reasonable.”^{21/} The Joint Utilities, however, do not assert that their rates, as a whole, are currently unfair and unreasonable, nor that the financing costs associated with their prepaid pension assets are jeopardizing their ability to access capital at favorable rates.

C. Cash accounting as compared with FAS 87 accounting.

In contrast to FAS 87, a utility can recover its pension costs in rates under a cash method of accounting in which the projected annual costs of the pension plan are reflected in rates. Like FAS 87, a cash method of accounting also will generate income that equals total pension costs over the life of the plan.^{22/} The difference between FAS 87 and cash accounting is that FAS 87 has the benefit of smoothing pension costs over time, creating more even cost recovery from customers, while cash accounting has the benefit of ensuring that large prepaid pension assets or accrued pension liabilities are not created.^{23/}

^{18/} Id. at 12:10-21.

^{19/} Id. at 10:14-18.

^{20/} Id.

^{21/} Id. at 10:22-23.

^{22/} Staff/300 at 5:4-8.

^{23/} Id. at 5:8-6:2; NWIGU-ICNU/300 at 12:11-14.

Due to the existence of the Joint Utilities' prepaid pension assets, the Commission requested additional testimony from all parties on the advisability of remaining with FAS 87 as opposed to switching to cash accounting.^{24/} In those rounds of testimony, there was general consensus that it was preferable to remain with FAS 87 given the complications associated with switching to cash accounting.^{25/}

III. ARGUMENT

A. The Joint Utilities have the burden of proof in this case.

This investigatory docket constitutes a contested case proceeding under both the Administrative Procedure Act and the Commission's Internal Operating Guidelines because it constitutes a trial-like process complete with testimony and evidence, a hearing, and briefing.^{26/} Accordingly, the Commission is acting in a quasi-judicial capacity as a decision-maker.^{27/} It should, therefore, adhere to the general rule for contested cases that the "burden of presenting evidence to support a fact or position ... rests on the proponent of the fact or position."^{28/}

The Commission's task in this proceeding is to rule on a Joint Utility request. In their opening testimony in this case, the Joint Utilities state that they are "requesting that the Commission allow for the recovery in rates the financing costs that the Joint Utilities incur as a result of timing differences between cash contributions to their pension plans and the recognition

^{24/} Docket No. UM 1633, Ruling & Notice of Prehearing Conference (May 8, 2014).

^{25/} NWIGU-ICNU/300 at 4:21-24; Staff/300 at 2:4-16; Joint Testimony/500 at 3:16-25; CUB/300 at 29:14-30:18 (CUB supported a switch to cash accounting under specific circumstances).

^{26/} ORS § 183.310(2)(a); Docket No. UM 1709, Order No. 14-358 at 7-8 (Oct. 17, 2014).

^{27/} Docket No. UM 1709, Order No. 14-358 at 7.

^{28/} ORS § 183.450(2). Although this statute is not applicable to the Commission, ORS § 183.315(6), it nevertheless accords with the Oregon Supreme Court's holding that "the burden of proof should be placed, as is usual in judicial proceedings, upon the one seeking change." Fasano v. Bd. of County Comm'rs, 264 Or. 574, 586 (1973), overruled on other grounds, Neuberger v. City of Portland, 288 Or. 585, 590 (1980).

of expense.”^{29/} Similarly, in briefing the question of whether to bifurcate this investigation when it was still in the early stages, the Joint Utilities stated that they would use the docket to “present a modification to the Commission’s methodology for pension cost recovery.”^{30/} As the proponent for the issue to be determined, the Joint Utilities should have the burden to demonstrate the reasonableness of their position.

The Joint Utilities have the opportunity to do so under the procedural schedule in this case, which has proceeded as if the Joint Utilities had the burden of proof. The Joint Utilities had the first word to present their proposal in opening testimony, and they will have the last in briefing, giving them a full opportunity to carry their burden to justify their proposal.

Indeed, granting the Joint Utilities’ request without holding them to a burden of proof would accomplish an end-around the burden they would otherwise bear in a rate case. In previous rate case filings, PacifiCorp, PGE, NW Natural, and Avista all have requested rate base treatment of their prepaid pension assets, similar to their request in this docket, or a balancing account for pension costs.^{31/} It is unquestionable that these utilities bore the burden of proof in those dockets to demonstrate that this treatment was just and reasonable.^{32/} There is no reason why the burden of proof should change here simply because this is a UM docket rather than a UE or UG docket. The issue to be resolved is identical. If the Commission finds in this docket that the Joint Utilities should be allowed to include their prepaid pension assets in rate base without

^{29/} Joint Testimony/100 at 2:19-22.

^{30/} Docket No. UM 1633, Joint Utilities’ Opening Brief on Bifurcation Proposal at 3 (May 7, 2013).

^{31/} In re PacifiCorp Request for General Rate Revision, Docket No. UE 263, PAC/900 at 2-6 (Mar. 1, 2013); In re PGE Request for General Rate Revision, Docket No. UE 215, PGE/500 at 28-31 (Feb. 16, 2010); In re PGE Request for General Rate Revision, Docket No. UE 262, PGE/500 at 30-32 (Feb. 15, 2013); In re PGE Request for General Rate Revision, Docket No. UE 283, PGE/600 at 31-32 (Feb. 13, 2014); In re NW Natural Request for General Rate Revision, Docket No. UG 221, NWN/400 at 27-31 (Dec. 30, 2011); In re Avista Request for General Rate Revision, Docket No. UG 246, Avista/600 at 14-16 (Aug. 14, 2013).

^{32/} ORS § 757.210(1); Docket No. UE 116, Order No. 01-787, 212 P.U.R.4th 379, *10-*14 (Sept. 7, 2001).

holding them to a burden of proof, then the Joint Utilities need not demonstrate in a later rate case that such treatment of their prepaid pension assets is necessary for just and reasonable rates. The Commission should require the Joint Utilities to justify their proposal, as they would be expected to do in any other quasi-judicial proceeding.

B. The Joint Utilities’ request to include their prepaid pension assets in rate base constitutes single-issue ratemaking.

In addition to regulating in the public interest, the Commission’s paramount duty is to ensure that the rates of the utilities it regulates are “fair and reasonable.”^{33/} To accomplish this, the Commission “balance[s] the interests of the utility investor and the customer.”^{34/} “Rates are fair and reasonable ... if the rates provide adequate revenue both for operating expenses of the public utility ... and for capital costs of the utility” with an adequate return to the equity holder.^{35/}

Because these ratemaking standards apply “with regard to a utility’s overall service, investments, and earnings,”^{36/} it is generally accepted that it is bad policy to engage in single-issue ratemaking. As the Illinois Supreme Court has phrased it:

The rule against single-issue ratemaking recognizes that the revenue formula is designed to determine the revenue requirement based on the *aggregate* costs and demand of the utility. Therefore, it would be improper to consider changes to components of the revenue requirement in isolation. Oftentimes a change in one item

^{33/} ORS § 756.040(1); see also, Wah Chang v. PacifiCorp, Docket No. UM 1002, Order No. 09-343 at 37-39 (Sept. 2, 2009) (Comm’r Savage, dissenting).

^{34/} ORS § 756.040(1); In re PacifiCorp Application to Implement the Provisions of Senate Bill 76, Docket No. UE 219, Order No. 10-364 at 8 (Sept. 16, 2010).

^{35/} ORS § 756.040(1).

^{36/} Docket No. UE 219, Order No. 10-364 at 8.

of the revenue formula is offset by a corresponding change in another component of the formula.^{37/}

The Commission takes a similar view: “we may not focus on one cost element while ignoring others. Because increases elsewhere may offset decreases, a change to one cost element does not, by itself, automatically require an adjustment to rates.”^{38/} For these reasons, the “Commission does not engage in single issue ratemaking.”^{39/}

The basis of the Joint Utilities’ request to include their prepaid pension assets in rate base is that “pension cost recovery [] is no longer fair or reasonable.”^{40/} They do not assert that their overall rates are, or have been, unfair and unreasonable. Nevertheless, the Joint Utilities have requested not that the Commission consider whether inclusion of the prepaid pension asset in rate base is necessary for fair and reasonable rates, but that it issue an order categorically allowing them to include their prepaid pension assets in rate base without any showing of need.^{41/} If it accepts this proposal, the Commission will essentially be making a finding that inclusion of the prepaid pension asset in rate base is necessary to establish “fair and reasonable rates” for the Joint Utilities without examining the full picture of their costs and revenues. This is single-issue ratemaking. The Commission should not accept the Joint Utilities’ categorical proposal.

^{37/} Bus. & Prof. People for Pub. Interest v. Ill. Comm. Comm’n, 585 N.E.2d 1032, 1061 (Ill. 1991) (emphasis in original).

^{38/} In re PGE Request for a General Rate Revision, Docket Nos. UE 180/UE 184, Order No. 07-454 at 5 (Oct. 22, 2007).

^{39/} City of Portland v. PGE, Docket No. UM 1262, Order No. 06-636 at 7 (Nov. 17, 2006).

^{40/} Joint Testimony/100 at 10:22-23.

^{41/} See id. at 10:2-11; Joint Testimony/500 at 21:3-5.

The overall reasonableness of a utility's rates has informed other commissions' decisions to deny the utility a return on its prepaid pension asset. The Utah Public Service Commission has held that the utility's:

[C]laim that shareholders' funds have been used without compensation must be judged by an earnings, not a single-item accounting, test Regulation assumes that over time, through a succession of rate cases, the risks of the [utility] over- or underearning in periods following rate cases will be borne equally by shareholders and ratepayers. A rate case is premised upon test year over- or underearnings, not alleged failure to recover a single expense or investment.^{42/}

Likewise, the Connecticut Department of Public Utility Control ("CDPUC") has found that:

[P]ension expense, whether it is good or bad, is a normal SFAS expense that impacts the income statement in all utilities and therefore should appropriately continue, with no special accounting treatment or additional return, to run through O&M as it has in the past under the traditional regulatory umbrella. The Department notes that this has and continues to be part of the overall regulatory formula that develops appropriate rates for the [utility].^{43/}

After finding that the utility had achieved an adequate return on equity and had solid financial metrics, the CDPUC determined that:

These levels of financial adequacy have all been attained in the presence of a prepaid pension asset with no special accounting treatment requested or allowed in the past. Accordingly, the Department finds the [utility] to be experiencing no significant cash or financial problems as a result of the pre-paid pension asset's current regulatory treatment.^{44/}

There has been no showing in this docket – nor could there be – that the Joint Utilities' overall rates have not been "fair and reasonable" under Oregon's legal standard. The Joint Utilities assert that 2008 was the triggering year in which new circumstances created

^{42/} In re U.S. West Commc'ns, Inc., Docket No. 97-049-08, 183 P.U.R.4th 382 at *21 (Dec. 4, 1997).

^{43/} In re Conn. Light & Power Co., Docket No. 03-07-02, 229 P.U.R.4th 380 at *129 (Dec. 17, 2003).

^{44/} Id.

unusually large prepaid pension assets with unusually high financing costs.^{45/} Yet, with the exception of Cascade, each of the Joint Utilities has had rate cases since 2008; all of them were resolved via settlement or Commission order finding that the overall rates were fair and reasonable and met the standard in ORS § 756.040;^{46/} and the Joint Utilities did not contest this determination in any of these cases.^{47/}

Accordingly, the Joint Utilities have not satisfied their burden to demonstrate that a change to the Commission's current policy is necessary to assure them fair and reasonable rates as a whole. There is, therefore, no basis on which to justify a change to the current policy, which allows the Joint Utilities a return *of* their prepaid pension assets through FAS 87 expense but no return *on* those assets.

C. Including the prepaid pension asset in rate base would be asymmetrical and inequitable.

Just as the Joint Utilities' current financial circumstances do not warrant a modification in Commission policy, neither do the external reasons these utilities put forward to justify their proposal. The Joint Utilities assert that new federal funding requirements under the Pension Protection Act, coupled with the 2008 market crash, constitute sufficiently changed circumstances that it is now necessary to include the prepaid pension asset in rate base.^{48/} Not

^{45/} Joint Testimony/200 at 9:2-8.

^{46/} ORS § 757.040(1) (Commission shall obtain for customers "adequate service at fair and reasonable rates").

^{47/} PacifiCorp had rate cases in 2009 (UE 210, resolved via stipulation), 2010 (UE 217, resolved via stipulation), 2012 (UE 246, resolved partially via stipulation and partially via Commission order), and 2013 (UE 263, resolved via stipulation); PGE had rate cases in 2008 (UE 197, resolved partially via stipulation and partially via Commission order), 2010 (UE 215, resolved via stipulation), 2013 (UE 262, resolved via stipulation), and 2014 (UE 283, resolved via stipulation); NW Natural had a rate case in 2011-2012 (UG 221, resolved partially via stipulation and partially via Commission order); Avista had rate cases in 2009 (UG 186, resolved via stipulation), 2010-2011 (UG 201, resolved via stipulation), 2013 (UG 246, resolved via stipulation), and has one pending (UG 284).

^{48/} Joint Testimony/100 at 10:22-23.

only does the evidence in this docket not support this assertion, it also does not justify a switch in pension cost recovery that would create inequitable results.

As Staff has shown, both PGE and NW Natural had prepaid pension asset balances at the end of 2013 that are roughly equivalent to, or even less than, the balance that existed prior to 2008.^{49/} Neither company sought to recover financing costs on their pre-2008 balances. In response to this observation, PGE testifies that the “issue of the timing differences between the build-up of the prepaid pension asset and its amortization through expense has been around since the inception of FAS 87. The point at which PGE sought regulatory treatment of this mismatch is irrelevant.”^{50/} ICNU/NWIGU can scarcely conceive of a statement that would better undercut the Joint Utilities’ justification for seeking a change in regulatory treatment of pension costs now. If nothing has changed about the dynamics of FAS 87 expense, and if those same dynamics led to pension asset balances comparable to, or higher than, they are today, then it is unclear why a change to the current policy at this time could be warranted when no such change was necessary in the past.

Moreover, a midstream shift in pension cost recovery of the type the Joint Utilities are requesting does not recognize the long-term effects of FAS 87. Idaho Power offers a contemporary example of the inequity of the Joint Utilities’ position. Among the major utilities the Commission regulates, it is the only one currently with an accrued pension liability.^{51/} The utility testifies that “the level of pension cost recovery included in Idaho Power’s Oregon rates is based on a FAS 87 determination of annual pension expense, as established in the Company’s

^{49/} Compare Staff/100 at 6:9 with Staff/200 at 10:10-11. Some of the Joint Utilities are still finalizing the balances of their prepaid pension assets for the end of 2014. Future briefing will reflect updated data.

^{50/} PGE/100 at 3:8-10.

^{51/} Idaho Power/100 at 6:10.

last general rate case. The level of recovery included in the Company's rates remains fixed until modified as part of a future general rate case."^{52/} As ICNU/NWIGU understands it, this means that Idaho Power is currently collecting FAS 87 expense from customers, thus increasing rates, even though inclusion of its accrued pension liability in rate base, pursuant to the Joint Utilities' proposal, would reduce customer rates.^{53/} Not surprisingly, the utility goes on to testify that it "believes that the existing regulatory treatment for the recovery of pension cost in the Oregon jurisdiction sufficiently provides Idaho Power with a reasonable opportunity to recover its prudently incurred pension costs *at this time* and should remain unchanged."^{54/} The utility has requested that it be exempted from a Commission decision allowing rate base treatment of the prepaid asset/accrued liability account,^{55/} which, of course, would allow it to continue to over-recover FAS 87 expense from customers. It also notes that it does not expect to have an accrued liability forever.^{56/} Given Idaho Power's testimony that it is satisfied with the current recovery policy "at this time," one wonders whether the utility will modify its position if it does eventually accumulate a prepaid asset and the one-sided nature of its FAS 87 recovery starts going in the other direction.

In a similar vein, the Joint Utilities have, in the past, been content to stick with the Commission's current pension cost recovery policy when they had accrued pension liabilities.

PacifiCorp admits that it had "an average accrued liability of \$63 million per year" between 1998

^{52/} Idaho Power/200 at 1:22-2:1.

^{53/} Idaho Power's last general rate case was initiated in 2011 (Docket No. UE 233). In that case, the utility stated that its actuary "provided a total 2011 net periodic pension expense estimate (SFAS 87) of \$27,954,213 of which Oregon's allocated portion is \$893,024. This is an \$8,788 increase over the amount included in the 2010 Base." In re Idaho Power Company Request for a General Rate Revision, Docket No. UE 233, Idaho Power/802 at 22 (July 29, 2011).

^{54/} Idaho Power/200 at 2:17-20 (emphasis added).

^{55/} Docket No. UM 1633, Idaho Power's Reply Brief on Bifurcation Proposal at 2-4 (June 21, 2013).

^{56/} Idaho Power/100 at 9:3-12.

and 2005.^{57/} If included in rate base, this accrued liability would have reduced rates. The utility argues that this should not matter because it had a prepaid pension asset in later years that counterbalanced this accrued liability.^{58/} But this is precisely the point. Over time, things average out. What once was an accrued liability becomes a prepaid asset, which may become an accrued liability again. Requesting different ratemaking treatment only when a prepaid asset exists does not recognize, or fairly reflect, the long-term effects of FAS 87.

NW Natural is another example. The utility points out that it shared negative FAS with customers in its 1998 rate case and that complaints that the utility's rates were not further reduced between rate cases when FAS expense became "more negative" are simply the realities of regulatory lag.^{59/} Yet, in this case, regulatory lag seems to only go one way. Had the Commission accepted NW Natural's proposal to include its prepaid pension asset in rate base in its 2012 rate case, the utility's rates would have reflected the pension asset when it was at its highest level.^{60/} Just one year later, however, NW Natural's pension asset decreased by \$10 million, approaching its 2008 level.^{61/} Yet, because of "regulatory lag," its rates today would still reflect the higher amount. The Joint Utilities are simply cherry-picking a point in time to maximize their return on the prepaid pension asset. The Commission should not grant such a one-sided request.

Indeed, at least one other commission has found that the same changed circumstances the Joint Utilities rely on for requesting different treatment of their pension costs today do not warrant it. In the precise inverse of the current situation, the staff of the Colorado

^{57/} PAC/100 at 3:11-12.

^{58/} Id. at 3:12-16.

^{59/} NWN/100 at 8:8-9:2.

^{60/} Staff/100 at 6:9 (2012 column).

^{61/} Staff/200 at 10:10-11; Staff/100 at 6:9.

Public Utilities Commission (“CPUC”) recommended removing the prepaid pension asset from a utility’s rate base.^{62/} The CPUC had allowed inclusion of this asset in rate base years earlier when it was an accrued pension liability, and thus, reduced rate base.^{63/} The staff alleged that, due to the Pension Protection Act and market crash of 2008, the utility’s pension liability became a pension asset.^{64/} Staff argued that these changed circumstances “no longer make it reasonable to ... permit the [utility] to profit off the financing of this employee benefit.”^{65/} The administrative law judge in the proceeding, however, was unpersuaded: “The nub of this issue is the undeniable fact that the prepaid pension asset that was once positive (and thus reduced rate base) is now negative (and thus increases rate base). This is an insufficient basis for changing the regulatory treatment of the prepaid pension asset.”^{66/} The ALJ noted “that the 2008 market losses are not permanent and that their effects will be diluted, if not eliminated, over time.”^{67/} The CPUC affirmed this portion of the ALJ’s order.^{68/}

Just as the Pension Protection Act and 2008 market crash were not sufficient for the CPUC to modify its policy to *remove* the prepaid pension asset from rate base, these circumstances should not be sufficient for the Commission to modify its policy to *include* the prepaid pension asset in rate base. The Joint Utilities have not demonstrated that any financing costs they are incurring associated with the prepaid pension assets are permanent and necessitate an asymmetrical and inequitable shift in the Commission’s pension cost recovery policy.

^{62/} In re Advice Letter No. 830, Colo. Pub. Utils. Comm’n Proceeding No. 12AL-1268G, Dec. No. R13-1307, 2013 Colo. PUC LEXIS 1079 ¶ 199 (Oct. 22, 2013).

^{63/} Id. ¶¶ 197, 201.

^{64/} Id. ¶¶ 199, 200.

^{65/} Id. ¶ 199.

^{66/} Id. ¶ 209.

^{67/} Id.

^{68/} In re Advice Letter No. 830, Proceeding No. 12AL-1268G, Dec. No. C13-1568, 2013 Colo. PUC LEXIS 1302 (Dec. 11, 2013).

D. The Commission's current policy best balances the interests of the Joint Utilities and their customers.

The Joint Utilities have attempted to frame their proposal as a straightforward application of standard ratemaking principles in which the Commission provides for a return of and return on utility investments.^{69/} Such ratemaking treatment, however, typically applies to investment in utility plant used to provide essential service to customers. Even in situations where the Joint Utilities allege that the Commission allows a return on non-plant assets, the examples they give are pre-purchases of materials and fuel stock costs – investments in tangible items that are used to provide identifiable services to customers.^{70/} The prepaid pension asset, on the other hand, is not necessary to ensure the Joint Utilities can provide service to customers.^{71/} Rather, it is a temporary accounting item on the Joint Utilities' books. Merely alleging, then, that the Joint Utilities have invested in the prepaid pension asset should not automatically entitle them to a return from customers on that investment. A balancing of investor and customer interests should involve a more comprehensive evaluation. This includes, as already discussed, a determination as to whether a return on the prepaid pension asset is necessary for fair and reasonable rates overall, as well as whether changing the ratemaking treatment of pension costs at this time would be equitable. It also should include a determination of which party is in the best position to bear these financing costs.

In this case, allowing the Joint Utilities to include the prepaid pension asset in rate base could create the wrong incentives. That the prepaid pension asset is not a typical rate base item matters for a number of reasons. First, unlike traditional rate base items that are subject to a

^{69/} Joint Testimony/100 at 12:7-21.

^{70/} Id. at 13:1-20.

^{71/} In re Conn. Light & Power Co., 229 P.U.R.4th 380 at *129.

predictable depreciation schedule, the prepaid pension asset fluctuates in value.^{72/} Thus, granting the Joint Utilities a return on the current value of their prepaid pension assets could result in significant over-recovery. If the value of those prepaid pension assets subsequently decreases, the Joint Utilities will nevertheless continue to earn a return on the higher balance for as long as they refrain from filing a new rate case, even if the prepaid pension asset becomes an accrued pension liability.

Second, and alternatively, unlike traditional rate base items, which necessarily depreciate in value, the prepaid pension asset does not.^{73/} The parameters for annual contributions to a pension plan are typically ERISA and/or Pension Protection Act required minimums and the maximum tax-deductible amount.^{74/} These parameters are often far apart in amount and management has funding discretion between them.^{75/} If the prepaid pension asset is included in rate base, the Joint Utilities would have little incentive to reduce it, and arguably would have an incentive to increase it.

Under either scenario, then, the Joint Utilities would have the ability to maximize their return on the prepaid pension asset at the expense of customers. While ICNU/NWIGU does not intend to suggest that the Joint Utilities will do this, the incentive is there. Conversely, by requiring the Joint Utilities to bear the financing costs associated with their prepaid pension assets, management is likely to take these costs into account (as any competitive enterprise would) in making its discretionary pension contributions. This puts the onus of prudent management on the utility, where it belongs.

^{72/} Staff/100 at 11:8-17.

^{73/} Id.

^{74/} NWIGU-ICNU/300 at 6:14-7:2.

^{75/} Id.

The existence of the prepaid pension asset is the result of a number of circumstances and decisions. Many of these – like the level of contributions made to the Joint Utilities’ pension plans in prior years – were at least partially the result of voluntary decisions by the Joint Utilities. While others, like market performance, are outside of the Joint Utilities’ control, their impact on the prepaid pension asset results directly from these utilities’ voluntary decision to have a pension plan in the first place. Customers, on the other hand, have control over none of these circumstances or decisions.

Given all of this, the Commission’s current policy regarding recovery of pension costs best “balances the interests of the utility investor and the consumer” and should be maintained.^{76/} It assures the Joint Utilities of recovery *of* their prepaid pension assets over the life of their pension plans; recognizes the temporary nature of the prepaid pension asset; and requires the Joint Utilities to bear a reasonable level of risk associated with decisions they made voluntarily and unilaterally.

E. The Joint Utilities’ burden to demonstrate that they are entitled to a return on the prepaid pension asset would likely be insurmountable.

The Joint Utilities request in this docket to include their prepaid pension assets in rate base. They must, therefore, show that: (1) investors have contributed to the prepaid asset balance such that the utilities are, in fact, incurring financing costs; and (2) these investments were prudent at the time they were made.

The Joint Utilities have not shown in this docket that their prepaid pension assets consist of investor funds, which carry a financing cost, rather than excess investment returns, which do not. Instead, the Joint Utilities have argued that the composition of their prepaid assets

^{76/} ORS § 756.040

is irrelevant because, even if they consist of excess investment returns, these excess returns reduce future FAS 87 expense, thus benefitting customers.^{77/} This, however, is beside the point. “A basic premise of regulatory philosophy is that utilities are allowed to earn a reasonable rate of return on invested capital. *If property has no capital cost, however, no return is allowed.*”^{78/} Without demonstrating that the prepaid pension asset consists of invested capital, the Joint Utilities should not be allowed to place it in rate base.^{79/}

Additionally, even when capital is invested, the utility must show that this investment was prudent before it can seek recovery in rates. “The prudence standard is traditionally used to address the proper valuation of utility investment in rate base. Any investment found to be unreasonable is deemed imprudent and subject to partial or full disallowance [The] Commission has long used the [prudence] standard when examining utility investments.”^{80/}

The Joint Utilities argue that “[b]ecause the Commission has reset each company’s FAS 87 recovery in the context of general rate cases, the contributions giving rise to the prepaid pension asset have already been subject to prudence reviews.”^{81/} Nothing could be further from the truth. Because the prepaid pension asset represents the difference between FAS 87 expense included in rates and the total funding level of the pension plan, any utility contributions included in the prepaid pension asset have, by definition, *not* been included in

^{77/} Joint Testimony/500 at 19:10-14.

^{78/} Pacific Power & Light Co. v. Dept. of Revenue, 308 Or. 49, 52 (1989) (emphasis added).

^{79/} Furthermore, the Joint Utilities’ argument that excess returns benefit customers by reducing future FAS 87 is hardly justification for their proposal to increase rates based on these excess returns, which is what would occur if the Joint Utilities included their prepaid pension assets in rate base. Excess returns benefit everyone, utilities included, because they help to fully fund the pension plan.

^{80/} In re PacifiCorp Request for a General Rate Revision, Docket No. UE 246, Order No. 12-493 at 25 (Dec. 20, 2012).

^{81/} Joint Testimony/500 at 17:16-19.

rates.^{82/} Accordingly, ICNU/NWIGU, Staff, and CUB have all argued that it would be necessary to review historical utility cash contributions in excess of FAS 87 expense to determine prudence.^{83/}

The Commission has retroactively reviewed a utility's expenses in a prior rate case to determine fair and reasonable rates.^{84/} The difficulty of doing so in this circumstance, however, would be magnified exponentially because the Commission would need to examine not just one prior rate case, but many that have occurred over the past few decades. It is not clear that the necessary records survive to create a full picture of the issue and, even if they do, it is often impossible to know what level of pension expense was included in rates established via settlement that did not include a specific pension cost.^{85/}

It is easy for the Joint Utilities to argue that a prudence review of the cash contributions that have contributed to the prepaid pension assets over the years is unnecessary, as such a review could only result in the Joint Utilities collecting a return on less than their full prepaid pension assets. It is not, however, appropriate to include costs in rates that have not received even a cursory review of their reasonableness. Whether the Joint Utilities could satisfy their burden to demonstrate that they made prudent contributions to the pension fund in these prior years is far from clear.

^{82/} NWIGU-ICNU/400 at 5:9-13.

^{83/} Id. at 5:14-6:3; Staff/300 at 18:11-19.; CUB/200 at 6:6-10.

^{84/} In re Application of PGE for an Investigation into Least Cost Plan Plant Retirement, DR 10, UE 88 & UM 989, Order No. 08-487 at 54-79 (Sept. 30, 2008).

^{85/} CUB/200 at 6:10-23.

F. If the Commission determines that a change to the recovery of pension costs in rates is warranted, it should limit the scope of its decision.

If this docket has illuminated anything, it is that accounting for pension costs is complex and utility-specific. Each utility switched to FAS 87 accounting at a different time;⁸⁶ whether the prepaid pension asset has increased primarily through investor contributions or through higher than expected market returns likely differs for each utility;^{87/} some utilities have had large accrued pension liabilities in the past and some have not;^{88/} some continue to see their prepaid pension assets increase while others are showing a decline.^{89/}

As already discussed, ICNU/NWIGU recommend that the Commission continue with its current policy of recognizing FAS 87 expense in rates and nothing more. The Joint Utilities have been using FAS 87 to set rates for 16 years or longer and it has worked well throughout this time.^{90/} Moreover, including the prepaid pension asset in rate base raises a number of significant equitable and evidentiary issues.

If, however the Commission determines that it may be appropriate for a utility to earn a return on its prepaid pension asset, then given the Joint Utilities' different circumstances, as well as the single-issue ratemaking issues discussed above, ICNU/NWIGU recommend that the Commission limit the scope of its decision by refraining from adopting a one-size-fits-all policy in this docket. The ultimate decision of whether it is appropriate to include the prepaid pension asset in rate base should be reserved for each utility's next rate case.

^{86/} Staff/100 at 12:8-9.

^{87/} See Joint Testimony/500 at 19:2-14.

^{88/} Staff/100 at 6:9.

^{89/} Staff/200 at 10:10-11.

^{90/} Staff/100 at 12:8 (PacifiCorp was the last utility to switch to FAS 87 for ratemaking purposes, in 1998).

Moreover, given the important distinctions between the prepaid pension asset and traditional rate base items discussed above, the utility should have a separate burden in its next rate case to show that earning a return on the prepaid pension asset is necessary to establish overall rates that are fair and reasonable. If, for instance, the current value of a utility's prepaid pension asset is less than in any previous year, then a presumption should attach that inclusion of the prepaid pension asset in rate base is not necessary. If the utility was operating with just and reasonable rates while carrying a prepaid pension asset on its books of higher value than currently exists, then it is difficult to understand why the utility would need to include its prepaid pension asset in rates now. Furthermore, in Conn. Light & Power Co., the CDUP examined the utility's credit ratings and credit metrics in determining not to allow the utility to earn a return on its prepaid pension asset.^{91/} Similarly here, if the utility has solid investment grade credit ratings and credit metrics that demonstrate its ability to obtain access to capital at favorable rates without its prepaid pension asset in rate base, then a presumption should attach that inclusion of the prepaid pension asset in rate base is unnecessary.

Additionally, to the extent a return on any part of the prepaid pension asset is allowed, it should only apply to that portion that the utility can clearly demonstrate: (1) investors have funded, such that financing costs are, in fact, being incurred; and (2) represent prudent contributions to the pension plan. Staff and CUB may have additional limitations that ICNU/NWIGU would support.^{92/}

^{91/} 229 P.U.R.4th at *129.

^{92/} Depending on the specific nature of a future request to include pension expenses in rate base, each of the Joint Utilities might encounter other legal hurdles, such as retroactive ratemaking. Any inquiry by the Commission in the future should address the facts of each case and each utility, and other parties should be allowed to raise such legal issues if warranted in the specific circumstance.

G. A switch to cash accounting from FAS 87 is not advisable.

Due to the fact that FAS 87 accounting for pension costs creates a prepaid pension asset or accrued pension liability, the Commission requested additional testimony on whether it would be advisable to switch to cash accounting.^{93/} While such a switch would eliminate the Joint Utilities' prepaid pension assets, the testimony from all parties on this issue indicates that switching to cash accounting would create more problems than it solves.

First there is the issue of what to do with the Joint Utilities' existing prepaid pension assets. The Joint Utilities are categorically opposed to switching to cash accounting if it means they are not allowed to recover the full value of these assets.^{94/} Conversely, the other parties all agree that, because the Joint Utilities have not demonstrated that the full amount of these assets represents investor funds, customers would be overcharged if the Joint Utilities were allowed to fully recover them as they currently exist.^{95/} Given the diametrically opposed positions of the parties on this issue, a switch to cash accounting appears untenable.

Second, cash accounting creates its own ratemaking problems. Because the amount necessary to fund a pension plan in any given year can fluctuate dramatically, switching to cash accounting has the potential to create large rate fluctuations, which implicates generational inequity issues.^{96/} Additionally, utility management has wide discretion over how much to fund the pension plan.^{97/} Under cash accounting, where the full projected amount would be collected from ratepayers, any management decision would need to be reviewed for prudence, or the Commission would need to place restrictions on this discretion, which could have

^{93/} Docket No. UM 1633, Ruling & Notice of Prehearing Conference (May 8, 2014).

^{94/} Joint Testimony/500 at 4:1-3.

^{95/} NWIGU-ICNU/300 at 13:8-10; Staff/300 at 14:1-4; CUB/300 at 13:7-9.

^{96/} Staff/300 at 9:18-10:17; NWIGU-ICNU/300 at 6:23-7:1.

^{97/} NWIGU-ICNU/100 at 34:21-35:7.

unintended negative consequences.^{98/} FAS 87 expense is determined by third parties, so such an intensive review of the inclusion of this expense in rates is not necessary.^{99/}

Finally, a switch to cash accounting may not solve the problems the Commission seeks to address by moving away from FAS 87. To address the rate fluctuations and generational inequity issues associated with cash accounting, the Commission could develop a balancing account for pension costs. However, as Idaho Power testifies:

If the Commission sees value in maintaining rate stability through a balancing account, it is likely that asset or liability balances will accumulate over time, representing the difference between cash contributed to the pension plan and revenue recovered from customers. In other words, utilities may be faced with the same problem of untimely recovery of cash contributed to the plan, except for different reasons.^{100/}

The difficulties of switching to cash accounting at this stage, where the Joint Utilities have used FAS 87 for decades, are simply too great to justify, particularly if they may not solve the very problems the Commission perceives with FAS 87.

IV. CONCLUSION

For the foregoing reasons, ICNU/NWIGU recommend that the Commission find that the current method of recovery of FAS 87 expense, and nothing more, provides the Joint Utilities with sufficient recovery of their pension costs in rates. If, however, the Commission decides that a change to its current policy may be warranted, ICNU/NWIGU urge the Commission not to make a categorical finding in this docket, and instead reserve for each utility's rate case a decision as to whether it is appropriate for the utility to earn a return on its

^{98/} NWIGU-ICNU/300 at 6:14-7:2.

^{99/} Staff/300 at 9:12-13.

^{100/} Idaho Power/200 at 6:7-12.

prepaid pension asset. To the extent a return is authorized, it should be limited to amounts the utility can demonstrate are investor-funded and prudent.

Dated this 30th day of January, 2015.

Respectfully submitted,

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