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VIA ELECTRONIC FILING AND FIRST CLASS MAIL

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: UM 1633 – In the Matter of OREGON PUBLIC UTILITY COMMISSION, Investigation into Treatment of Pension Costs in Utility Rates

Attention Filing Center:

On behalf of Avista Utilities, Cascade Natural Gas, NW Natural Gas, PacifiCorp, and Portland General Electric, (Joint Utilities), enclosed in the above-referenced docket are an original and five copies of Joint Utilities' Prehearing Brief. The filing has been served on the parties to the service list as indicated on the attached Certificate of Service.

Please contact this office with any questions.

Very truly yours,

Wendy McIndoo

Wendy McIndoo
Office Manager

cc: Service List

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM 1633

In the Matter of PUBLIC UTILITY COMMISSION OF OREGON, Investigation into Treatment of Pension Costs in Utility Rates.	**JOINT UTILITIES' PREHEARING BRIEF**

I. INTRODUCTION

In accordance with Chief Administrative Law Judge ("ALJ") Michael Grant's Prehearing Conference Memorandum dated July 10, 2014, Avista Corporation ("Avista"), Cascade Natural Gas Corporation ("Cascade"), Northwest Natural Gas Company ("NW Natural"), PacifiCorp d/b/a Pacific Power ("PacifiCorp"), and Portland General Electric Company ("PGE") (collectively, the "Joint Utilities") file this Prehearing Brief.

The Public Utility Commission of Oregon ("Commission") opened this docket in response to several recent rate cases in which individual utilities requested recovery of financing costs associated with the prepaid pension asset. In those cases, the utilities presented detailed information relevant to their specific circumstances, including the status of their prepaid pension asset, their history of contributions to pension plans, and their historical recovery under the Statement of Financial Accounting Standards No. 87 ("FAS 87").[1] After reviewing this information in a NW Natural general rate case, the Commission concluded that it wished to take a step back and consider—as a matter of general policy—the appropriate

[1] *See, e.g., Re Northwest Natural Gas Co.*, Docket UG 221, Order No. 12-408 at 4 (Oct. 26, 2012); *Re Portland General Elec. Co.*, Docket UE 215, Order No. 10-478 at 2-3 (Dec. 17, 2010).

treatment of pension expense in rates.[2] In declaring its intent, the Commission made clear that it would consider the issues on a "general, non-utility-specific basis"[3] and reserved individualized determinations for utility-specific ratemaking proceedings.[4]

Consistent with the scope of this generic docket, the Joint Utilities request the Commission find that, as a matter of general policy, it is appropriate for a utility's prepaid pension asset to be included in rate base.[5] The utilities already receive recovery of their pension "expense" through the recovery of FAS 87 expense.[6] However, under the current approach taken in Oregon, the utilities are not recovering the significant costs they incur to finance the cash contributions to their pension plans that exceed FAS 87. When contributions are prudently made in advance of their recovery through FAS 87 expense, the utilities incur costs to finance these payments. The cumulative amount the utilities spend on pension contributions exceeding cumulative FAS 87 expense constitutes the prepaid pension asset. Thus, it is appropriate to allow the Joint Utilities to recover the cost of financing contributions through the inclusion of the prepaid pension asset in rate base.

The Joint Utilities' request is reasonable and based on well-established ratemaking principles that allow utilities to earn a fair rate of return on funds invested on behalf of utility

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[2] Order No. 12-408 at 4,12 ("We will open a docket to review the treatment of pension expense on a general, non-utility-specific, basis.")

[3] *Id.*

[4] *Id.*; *see also Re Northwest Natural Gas Co.*, Docket UG 221, Staff Supplemental Brief at 2 (Oct. 5, 2012) ("[A] change in pension policy may also have far-reaching impacts for other utilities. For all of these reasons, Staff is open to pursuing alternatives to pension expenses, but believes such alternatives should be carefully weighed and vetted in a future proceeding and not in this rate case.").

[5] Joint Testimony/100, Joint Parties/2-3, 10.

[6] "Pension expense" includes both FAS 87 and Statement of Financial Accounting Standards No. 88 ("FAS 88") expense. FAS 88 requires immediate recognition of unrecognized costs whenever certain triggering events occur, such as a settlement or curtailment of a plan. Joint Testimony/200, Vogl/5-6. In some cases, FAS 88 expense has also been recovered.

customers.[7] The request is also consistent with Commission precedent, which recognizes that utilities must be allowed to earn a return on cash invested for customers' benefit.[8] Finally, the Joint Utilities' request is consistent with the policies of many state public utility commissions that allow recovery of the costs to finance pension contributions, by including the prepaid pension asset in rate base or in the calculation of cash working capital.[9]

Staff, the Northwest Industrial Gas Users, and the Industrial Customers of Northwest Utilities ("NWIGU-ICNU") generally agree that the prepaid pension asset represents an investment financed by utility shareholders on which a return should be earned, *subject to an investigation into the specific circumstances of each utility's pension contributions and recovery*. To the extent Staff and NWIGU-ICNU reject the Joint Utilities' position, that rejection is based largely on concerns about the specific circumstances they believe suggest that some portion of the prepaid pension asset may not represent a legitimate shareholder investment.[10] In particular, Staff and NWIGU-ICNU argue that before including a prepaid pension asset in rate base, the Commission must first consider a utility's history of how the

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[7] Jonathan A. Lesser, Ph.D. & Leonardo R. Giacchino, Ph.D., *Fundamentals of Energy Regulation*, 68-69 (2d ed. Public Utilities Reports 2013) ("When an investor makes his funds available to a firm, he is forgoing the option of using those funds for some other purpose (either current consumption or another investment). He is also putting his funds at some risk. Together, these conditions define the investor's *opportunity cost*. In exchange, the investor will expect to earn a return on his funds that is commensurate with that opportunity cost.") (emphasis in original).

[8] ORS 756.040 ("Rates are fair and reasonable for the purposes of this subsection if the rates provide adequate revenue both for operating expenses of the public utility or telecommunications utility and for capital costs of the utility, with a return to the equity holder that is: (a) Commensurate with the return on investments in other enterprises having corresponding risks; and (b) Sufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital."); *Re Portland General Elec. Co.*, Dockets DR 10, UE 88 & UM 989, Order No. 08-487 at 5 (Sept. 30, 2008) ("To protect the utility investor, the rates must provide sufficient revenue not only for operating expenses, but also for the capital costs of the business. If the rates do not afford sufficient compensation, the State has taken the use of the utility property without paying just compensation . . .") (internal quotations omitted).

[9] *See, e.g., WUTC v. PacifiCorp*, 2013 WL 6384505 at *72 (Wash.U.T.C.).

[10] Staff also raises concerns regarding single issue ratemaking with respect to the current prepaid pension asset. Staff's focus on utility-specific concerns relate to the prospective prepaid pension asset. Staff/100, Bahr/20-22.

prepaid pension asset built up over time, whether contributions to pension funds were prudently made, and whether at any point the utility's FAS 87 expense included in rates was greater or less than actual FAS 87.[11] The Citizens' Utility Board of Oregon ("CUB") is the only party advocating that the prepaid pension asset should under no circumstances be added to rate base. However, CUB's opposition is also based on utility-specific concerns.[12]

The Joint Utilities do not agree that the Commission must review historical utility-specific data in order to decide the issues in this case. Because general ratemaking principles and applicable policy considerations support the inclusion of the prepaid pension asset in rate base, the Commission should adopt the Joint Utilities' proposal as a matter of general policy, and reserve the review of the utility-specific concerns for future rate proceedings. In fact, it was utility-specific data and proposals from the other proceedings that led the Commission to conclude that it should *first* conduct this generic proceeding. Nevertheless, the Joint Utilities have addressed the utility-specific data offered by the other parties, and individual utilities have offered additional data of their own. Examination of that data demonstrates the majority of the parties' concerns are based on incomplete or erroneous analysis. In actuality, when viewed overall, the weight of the utility-specific data supports rather than undermines the Joint Utility proposal. Thus, the Commission should adopt a general policy of including the prepaid pension asset in rate base.

II. PENSION COST OVERVIEW

A. Pension Fundamentals

A pension plan is an employer-sponsored retirement plan that provides pre-defined payments to eligible employees after they retire.[13] To ensure that their pension plans have

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[11] NWIGU-ICNU/100, Smith/7. Staff makes this argument to support its alternative proposal. Staff/100, Bahr/21. Staff also argues that the current prepaid pension asset cannot be added to rate base because of concerns regarding single issue ratemaking. Staff/100, Bahr/20-21.

[12] *See, e.g.*, CUB/100, Jenks-McGovern/4.

[13] Joint Testimony/500, Joint Parties/5.

sufficient funds to pay each retired employee, the Joint Utilities are required to make periodic contributions to their funds. The amount and timing of the cash contributions is largely driven by the requirements of federal law and each utility's financial and credit metrics.[14] Like other utility investments, pension contributions are financed with a mix of debt and equity.[15]

While the Joint Utilities' contributions to their pension funds are made on a cash basis, they are reflected on the utilities' books on an accrual basis in accordance with the requirements of FAS 87.[16] The fundamental objective of FAS 87 is to recognize the expected cost of an employee's pension benefits over the employees' remaining years of service, matching changes in benefit obligations (due to market changes, salary and wage adjustments, etc.) with accounting expenses, while smoothing the changes over the years.[17] Over time cumulative FAS 87 expense, plus FAS 88 expense, if and when triggered (as discussed below), will equal cumulative contributions. However, at any one time, there will be differences—that is at any one time, cumulative FAS 87 expense will exceed cumulative contributions, or cumulative contributions will exceed cumulative FAS 87 expense. The difference between cumulative cash contributions and cumulative FAS 87 expense is accounted for as a **prepaid pension asset** when contributions exceed FAS 87 expense, or as an **accrued pension liability** when FAS 87 expense exceeds contributions. In this way, the prepaid pension asset represents each company's contributions to its pension plan that have yet to be expensed through FAS 87. Conversely, an accrued pension liability represents FAS

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[14] Joint Testimony/200, Vogl/6-7; Joint Testimony/600, Joint Parties/12.

[15] Joint Testimony/500, Joint Parties/5-6.

[16] Joint Testimony/100, Joint Parties/7; Joint Testimony/200, Vogl/4. FAS 87 expense equals the sum of the following: (1) service costs (value of benefits earned during the year); (2) interest costs (interest on the projected benefit obligation for the year); (3) expected return on pension plan assets; and (4) amortization of unrecognized costs (changes in plan liabilities due to plan changes, changes in actuarial assumptions, differences between expected and actual returns, and/or experienced gains or losses). As noted above, pension expense also includes FAS 88 expense.

[17] Joint Testimony/100, Joint Parties/9.

87 expense in excess of each company's contributions.[18] ***Because Oregon utilities currently recover their pension costs based on FAS 87 expense, the prepaid pension asset represents the cash contributions that were made by each company but not yet recovered in rates.***[19]

There are a few additional aspects of pension accounting that are critical to understanding the Joint Utilities' proposal. The first is the very direct relationship between cash contributions and FAS 87 expense. That is, cash contributions improve the funded status of the pension plans and thereby directly reduce future FAS 87 expense.[20] In this way, cash contributions provide a tangible benefit to utility customers.

A second issue arises when a plan is frozen or terminated early—that is, before the final pension payment has been made to the last beneficiary[21]—or when special termination benefits are provided under a pension plan.[22] In this case, in accordance with FAS 88, additional charges would be reflected in the utility books as expense, primarily resulting from accelerated recognition of amounts that would have otherwise been recognized as FAS 87 expense in the future. Over time, FAS 87 and FAS 88 expense together will equal cumulative contributions.[23]

B. Effect of the Pension Protection Act and the Recession on Prepaid Pension Assets

Prepaid pension assets and accrued liabilities pre-date the Pension Protection Act of 2006 ("PPA") and the 2008 financial crisis; however, those two events have contributed

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[18] Joint Testimony/500, Joint Parties/7.

[19] Joint Testimony/500, Joint Parties/7-8.

[20] Joint Testimony/500, Joint Parties/7-8.

[21] Joint Testimony/500, Joint Parties/20.

[22] CUB/404, Jenks-McGovern/1.

[23] Joint Testimony/100, Joint Parties/8-9.

significantly to the Joint Utilities' larger and more sustained prepaid pension assets.[24] By decreasing the period over which the unfunded pension liability is amortized, the PPA significantly accelerated and front-loaded the mandatory pension contributions, which has required utilities to use more cash to fund their pension plans sooner than would otherwise have been required.[25] The economic conditions caused by the 2008 recession—including both the market crash and declining interest rates—coupled with the increased funding requirements imposed by the PPA resulted in a dramatic increase in prepaid pension assets.[26] The growth in prepaid pension assets is not temporary and prepaid pension assets are expected to persist for the foreseeable future even as market conditions return to normal.[27]

III. ARGUMENT

A. The Prepaid Pension Asset Represents a Legitimate Utility Investment and the Joint Utilities Should Recover the Costs to Finance this Investment.

The crux of the Joint Utilities' case is straightforward. The Joint Utilities do not recover their cash contributions as they are made, but rather recover their pension costs through FAS

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[24] Joint Testimony/100, Joint Parties/10; NWIGU-ICNU/100, Smith/41 ("After the 2008 worldwide financial crisis and decline in many investments, many defined benefits pension plans experienced investment losses. These developments have led recently to some utilities recording large amounts for pension assets."); CUB/100, Jenks-McGovern/9 ("It is true that the recession and the Pension Protection Act required most pension sponsors to make pension contributions, which increased the size of their prepaid pension assets."); CUB/114, Jenks-McGovern/2 (Moody's reported that the "U.S. utility sector is losing ground with the funding status of its sizeable pension plans . . .We found that weak returns associated with the equity components of pension portfolios and falling discount rates have combined to eliminate the effects of **above-average annual contributions over the past few years**.") (emphasis added); CUB/114, Jenks-McGovern/4 (Moody's described pension funding pressures caused by recession); CUB/115, Jenks-McGovern/2 (Standard & Poor's observed that utilities' pension obligations were impacted by recession at a much quicker pace than rest of economy); CUB/115, Jenks-McGovern/6 (declining stock market and very weak economic conditions in 2008 caused significant deterioration of pension funding status); NWIGU-ICNU/103, Smith/13 (2009 GAO report observed that legislative changes coupled with recession led to significant stress on pension plan sponsors).

[25] Joint Testimony/200, Vogl/8.

[26] Joint Testimony/400, Vogl/2.

[27] Joint Testimony/100, Joint Parties/12; NWN/100, Wilson/10 (NW Natural's projections indicate that its prepaid pension asset will continue to grow significantly through 2023).

87 expense included in rates.[28] Because their cumulative contributions have exceeded their cumulative FAS 87 expense, the Joint Utilities all maintain prepaid pension assets that they have been required to finance. These prepayments have been prudently made and benefit customers by reducing FAS 87 expense. Therefore, they represent legitimate utility investments on which the utilities should earn a return. For these reasons, it is therefore appropriate to add the prepaid pension asset to rate base to allow the utilities to recover their financing costs.

1. General Ratemaking Principles and Oregon Law Support the Joint Utilities' Request.

By requesting that the prepaid pension be added to rate base, the Joint Utilities are asking that the prepaid pension asset be given the same treatment accorded to similar utility investments that are recovered over time and for which a return on investment is provided.

Oregon law requires rates to provide for the capital costs of the utility, including a return on equity "commensurate with the return on investments in other enterprises having corresponding risks; and [s]ufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital."[29] Accordingly, the Commission provides for the recovery of two aspects of utility investment: (1) the expense incurred, or the **"return of"** the investment; and (2) the costs to finance the investment, or the **"return on"** the investment. For example, in the case of physical plant, the Commission allows a "return of" the investment through the recovery of depreciation expense included in rates, and a "return on" the investment, by adding the asset to rate base.[30] The prepaid pension asset is

[28] Joint Testimony/500, Joint Parties/7-8.

[29] ORS 756.040(1); *Gearhart v. Pub. Util. Comm'n of Oregon*, 255 Or. App. 58, 61, *affirmed* 356 Or. 216 (2014) ("the PUC sets rates so as to provide a utility with an opportunity to recover its revenue requirement, which is the amount of money the utility must collect to cover its reasonable operating expenses incurred in providing services, as well as a reasonable return on investments made to provide that service").

[30] Joint Testimony/100, Joint Parties/12.

an investment made by the Joint Utilities on behalf of and for the benefit of customers.[31] Therefore, like all such investments, the Joint Utilities should be allowed to recover a return on the investment.

The prepaid pension asset is also analogous to cash working capital, which represents the funds required to enable a utility to operate its business on a daily basis.[32] Like the prepaid pension asset, cash working capital is necessary due to the "lag in time between the collection of revenues for services rendered [*i.e.*, FAS 87 expenses] and the necessary outlay of cash to pay the expense of providing those services [*i.e.*, cash contributions]."[33] Consistent with general principles of ratemaking, when working capital "funds have come from investor sources (debt and equity securities issued or earnings retained in the business), they are legitimate investments to provide service and thus, should be included in rate base."[34]

The cash contributions are also analogous to traditional utility prepayments, which "represent amounts expended (e.g., prepaid insurance and taxes) in providing utility service in advance of receiving the related goods or services."[35] Consistent with traditional ratemaking,

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[31] Joint Testimony/100, Joint Parties/7-8.

[32] *See Re Avista Corp.*, Docket UG 201, Order No. 11-080 at 5 (Mar. 10, 2011); *Re Pac. Power & Light Co.*, 86 P.U.R.3d 417 (Oct. 5, 1970) ("Working capital consists of materials and supplies and cash working capital."); *see also* Jonathan A. Lesser, Ph.D. & Leonardo R. Giacchino, Ph.D., *Fundamentals of Energy Regulation*, 69 (2d ed. Public Utilities Reports 2013) ("Working capital represents the amount of money a firm needs to 'bridge the gap between the time that expenditures are required to provide service and the time collections are received for that service.'") (quoting *Re Columbus Southern Power Co.*, 133 P.U.R.4th 525, 550 (Ohio P.U.C. 1992)).

[33] Order No. 11-080 at 5.

[34] James C. Bonbright, Albert L. Danielsen & David R. Kamerschen, *Principles of Public Utility Rates*, 243 (2d ed. Public Utilities Reports 1988); *Re Pac. Power & Light Co.*, 86 P.U.R.3d 417 (Oct. 5, 1970); *WUTC v. PacifiCorp*, 2013 WL 6384505 at *72 (Wash.U.T.C.) ("Working capital is included in rate base and earns a return.").

[35] James C. Bonbright, Albert L. Danielsen & David R. Kamerschen, *Principles of Public Utility Rates*, 244 (2d ed. Public Utilities Reports 1988).

the average balance of prepayments are included in a utility's rate base so that the utility is "compensated for this investment until the prepayments are expensed."[36]

Similarly, rate base regularly includes investments in material and supplies, such as fuel stock.[37] Utilities prudently acquire fuel stocks in excess of their immediate needs.[38] As the fuel is consumed, the utility expenses the cost and recovers that amount in rates. However, "[p]ending recovery of these costs from its customers, a utility is entitled to earn a return on the investor-supplied funds used to finance these inventories."[39] Allowing a utility to recover only the financing costs or only the fuel expense would not allow recovery of all prudently incurred costs.[40]

Thus, whenever there is a timing difference between a utility investment, and the recovery of the investment, the Commission's general policy is to allow the utility to recover its costs to finance the investment—except in the case of pension contributions.[41] Before the passage of the PPA and the 2008 recession, the utilities did not expect to maintain substantial prepaid pension assets for any significant period of time, and therefore the utilities did not request that the Commission's general policy be applied to the prepaid asset. But given the current circumstances, where the Joint Utilities all project that they will continue to maintain prepaid pension assets for some time, it is imperative for the Commission to change its policy and allow for the recovery of their financing costs.

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[36] *Id.*

[37] *Id.* ("Materials and supplies represent the inventory kept on hand by a utility to meet the day-to-day requirements of providing utility service.").

[38] Joint Testimony/100, Joint Parties/13.

[39] James C. Bonbright, Albert L. Danielsen & David R. Kamerschen, *Principles of Public Utility Rates*, 244 (2d ed. Public Utilities Reports 1988).

[40] Joint Testimony/100, Joint Parties/13; James C. Bonbright, Albert L. Danielsen & David R. Kamerschen, *Principles of Public Utility Rates*, 244 (2d ed. Public Utilities Reports 1988) ("Inclusion of average materials and supplies inventories in rate base provides the means of compensating the investors for this invested capital.").

[41] Joint Testimony/100, Joint Parties/10; Joint Testimony/600, Joint Parties/16.

2. Many State Public Utility Commissions Allow the Inclusion of the Prepaid Pension Asset in Rate Base.

The inclusion of a prepaid pension asset in rate base, or as a component of cash working capital, is not unusual or novel. On the contrary, the evidence suggests that at least half of the state public utility commissions allow utilities to earn a return on the prepaid pension asset. For instance, the Colorado Public Utilities Commission has allowed a utility to include the prepaid pension asset in rate base, pointing to the mandatory nature of pension contributions and explaining:

> In the Company's case, [federally]-mandated pension contributions have exceeded pension expenses derived pursuant to accounting principles. Currently, the Company recovers in rates, pension expenses based upon GAAP, instead of recovering the greater expenses [contributions] mandated by [federal law]. Shareholders are required to fund the additional amounts indicated by [federal law]. In order to compensate investors for the additional funds they supply to meet the higher contribution levels, the resulting prepaid assets are an appropriate addition to rate base.[42]

In 2003, the Department of Telecommunications and Energy of the Commonwealth of Massachusetts (DTE) issued an order in which it allowed four affiliated utilities to include their prepaid pension assets in rate base, explaining that there was no reason why a utility's pension costs should be treated any differently from other investments on which a utility is allowed to earn a return. Specifically, the DTE stated:

> As concerns utility pension and PBOP [post-retirement benefits other than pensions] in particular, the Federal Energy Regulatory Commission and, for example the regulatory agencies of a number of states include prepaid pension in rate base at the full cost of capital. We cite these instances from other jurisdictions to show the unexceptional nature of the issues before us.[43]

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[42] *Re Public Service Co. of Colo.*, 148 P.U.R.4th 1, 1993 WL 494141, *19 (Colo.P.U.C.).

[43] *Re Commonwealth Elec. Co. et al.*, 231 P.U.R.4th 21, 2003 WL 23282179, n. 2 (Mass.D.T.E.) (citing *Cities of Greenwood and Seneca, SC v. Duke Power Company*, 77 F.E.R.C. ¶ 63,017, at item 14 (Initial Decision) (1996)). The four utilities were Commonwealth Electric Company, Cambridge Electric Light Company, Boston Edison Company, and NSTAR Gas Company.

. . . .

> there really is no principled difference between the Companies' investment in rate base and their investment in pensions and PBOP. Both are long term investments and should be similarly treated. The Department also applies the weighted cost of capital to cash working capital, that long-term fund which must be set aside to draw on and then replenish for short-term needs. Like pension expenses, the demands on the cash-working capital fund may fluctuate; but the need for the fund or expense exists over the long-term and is treated accordingly.[44]

In February 2013, the Indiana Utility Regulatory Commission allowed Indiana Michigan Power Company to include its prepaid pension asset in rate base, observing that contributions to the prepaid pension asset benefitted ratepayers by preserving the integrity of the pension fund and reducing the total pension costs in the utility's revenue requirement by reducing FAS 87.[45]

In December 2013, the Washington Utilities and Transportation Commission allowed PacifiCorp to earn a return on its prepaid pension asset by including the asset in the calculation of PacifiCorp's cash working capital.[46] In that case, WUTC Staff supported PacifiCorp's proposal "because it achieves a proper balance of ratepayer interests and allows investors to earn a return on the net unamortized funds they contributed to employee post-retirement benefits."[47]

And on December 30, 2014, the Wyoming Public Service Commission (WYPSC) found the prepaid pension asset "is an asset that is appropriate to place in rate base" in Rocky Mountain Power's (a division of PacifiCorp) general rate case.[48] The WYPSC authorized recovery of the requested revenue requirement, partially reduced by a transitional adjustment

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[44] *Id.*

[45] *Re Indiana Michigan Power Co.*, 303 P.U.R.4th 384, 2013 WL 653036 32 (Ind.U.R.C.).

[46] *WUTC v. PacifiCorp*, 2013 WL 6384505 at *72 (Wash.U.T.C.).

[47] *Id.*

[48] *Re Rocky Mountain Power*, 2014 WL 7526282 at *36 (Wyo.P.S.C.).

proposed by an intervenor and agreed to by the Company, as an equitable alternative to initiate recovery of the prepaid pension asset in rate base.

In addition, regulators in the District of Columbia, Michigan, New York, Oklahoma, Ohio, Florida, Virginia, North Carolina, Maryland, Missouri, and Texas have also allowed utilities to include prepaid pension assets in rate base.[49] And as CUB's testimony indicated, Delaware and New Mexico have also allowed utilities to include a prepaid pension asset in rate base.[50]

Further, Staff's "Pension Treatment in Rate Making Survey," found that 16 commissions recognize a "Prepaid Pension Asset/Liability" through allowing "a return on amount invested in asset."[51] Three other commissions reported that they include cash contributions to prepaid pension asset in "Working Capital." Six other commissions used a "Combination of Methods," several of which included prepaid pension costs in rate base, or

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[49] Joint Testimony/100, Joint Parties/13-14; *see, e.g., Re Public Service Co. of Oklahoma*, 2007 WL 6081138, *7 (Okl.C.C.) ("PSO has included $82 million in prepaid pension assets . . . in rate base. This is the proper treatment of this item. The prepaid pension asset produces benefits for PSO's customers. Therefore, like any other asset PSO makes an investment in, the Company should be allowed an opportunity to earn a return on that investment."); *Re Florida Public Util. Co.*, 1989 WL 1640968 (Fla.P.S.C.) (including prepaid pension asset in cash working capital); *Re Appalachian Power Co.*, 2007 WL 1616129, *10-*11(Va.S.C.C.) (prepaid pension asset included in rate base as a prepayment "because prepaid pensions are directly tied to reducing operating expenses"); *Re North Carolina Nat. Gas Corp.*, 128 P.U.R.4th 321, 348, 1991 WL 501674 (N.C.U.C.) (including prepaid pension asset in cash working capital calculation); *Re Potomac Elec. Power Co.*, 258 P.U.R.4th 463, 2007 WL 2159658, *22 (Md.P.S.C.) ("pre-paid pension asset . . . equal to the amount of funding made to the plan in excess of the Financial Accounting Standards Board ('FASB')-determined expense" allowed in rate base in part because it reduced FAS 87 expense); *see also*, *Staff of the Mo. Pub. Serv. Comm'n v. Union Elec. Co.*, 90 P.U.R.4th 400, 1987 WL 258074 (Mo.P.S.C.); *Re Missouri Gas Energy*, 280 P.U.R.4th 107, 2010 WL 600010 ¶¶ 167-169 (Mo.P.S.C.) ("The prepaid pension asset reflects the difference between the amount of pension expense included in the cost of service and the actual level of pension expense incurred. That is, it is the difference between the pension expense included in rates and the amount funded by the company. If the actual pension expense exceeds the amount included in rates, [Missouri Gas Energy] records the difference as a regulatory asset. The asset is included in rate base, and the difference will be recovered through amortization of the asset in subsequent rate cases.").

[50] CUB/116; CUB/100, Jenks-McGovern/41; Joint Testimony/300, Joint Parties/11-12.

[51] Joint Testimony/100, Joint Parties/14.

otherwise earning a return on the asset. Based on all of the evidence, it appears that at least half of the state public utility commissions allow the utilities to recover their costs of financing the prepaid pension asset—either through rate base treatment of the prepaid pension asset, or cash working capital.

Thus, there is nothing unusual, novel or untested about the treatment the Joint Utilities seek. It is fully consistent with this Commission's policies—and standard ratemaking policies.

B. Staff and Intervenor Arguments Against the Joint Utilities' Proposal are Meritless.

1. Staff and Intervenor Utility-Specific Arguments are Inappropriate for this Phase of the Proceeding and Erroneous.

The fundamental issue in this case is whether the Joint Utilities' prepaid pension assets represent utility investments on which the utilities should be allowed to recover a return. The premise underlying the inclusion of a prepaid pension asset in rate base is that the Joint Utilities incur financing costs associated with the asset. On this point, the parties generally agree that the utilities *might* incur costs to finance the prepaid pension asset,[52] but that further inquiry is required to determine whether there are portions of the prepaid pension assets that do not represent bona fide utility investment.

For instance, NWIGU-ICNU opposes the Joint Utilities' proposal by arguing that "[r]ate base inclusion may be appropriate only if it can be reasonably demonstrated that reduced FAS 87 pension costs, including the pension credits, on a cumulative basis have been flowed through to the benefit of the utility's ratepayers in an amount at least equal to the prepaid

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[52] Staff/100, Bahr/20 ("financing cost of cash outlays in excess of those recognized under accrual accounting and regulatory recovery mechanisms does represent a real cost to the companies . . ."); NWIGU-ICNU/100, Smith/20; NWIGU-ICNU/200, Smith/11; CUB/100, Jenks-McGovern/28 (if utilities pass through negative FAS 87 to customers the utilities will incur a carrying charge because the utilities cannot take the pension income from the pension trust to fund the credit); CUB/300, Jenks-McGovern/17-18. Further, CUB relies on a report where Standard & Poor's observed that "[t]o fund cash contributions, companies may be compelled to divert cash flows away from other corporate purposes or issue debt that will be repaid with future operating cash flows." CUB/115, Jenks-McGovern/3.

pension asset to be included in rate base."[53] Based on this premise, NWIGU-ICNU concludes that the Joint Utilities have failed to provide the "fact-specific, utility-by-utility analysis of historical [pension] information" necessary to justify their proposal.[54] Similarly, CUB's justification for excluding the prepaid pension asset from rate base is based on its assessment of the individual utilities' past pension expenses and recovery.[55] As discussed below, according to CUB, the prepaid pension asset should not be included in rate base because the utilities, variously, recovered more FAS 87 expense than actually experienced, did not refund negative FAS 87 expense, and the prepaid pension asset may not have been the result of utility cash contributions.

These utility-specific arguments are inappropriate for this general policy docket. If at all relevant (and the Joint Utilities do not view them as relevant) they should be considered in individual rate proceedings where the utilities seek to add their prepaid pension assets to rate base. Moreover, as demonstrated below, these concerns are largely based on mistaken analysis or mischaracterizations of the utility data. Indeed, when the parties' utility-specific data and arguments are examined, they support rather than undermine the Joint Utilities' proposal.

a. The Joint Utilities' Historical FAS 87 Recovery Does Not Undermine Their Recommendation.

CUB and NWIGU-ICNU claim that before a prepaid pension asset can be included in rate base, the Commission must compare each utility's actual FAS 87 expense to that amount collected in rates.[56] These parties reason that if, over time, the amount estimated in utility rates for FAS 87 exceeded actual FAS 87 expense, then the utilities would be unable to

[53] NWIGU-ICNU/100, Smith/37.

[54] NWIGU-ICNU/100, Smith/7, 37.

[55] *See, e.g.*, CUB/100, Jenks-McGovern/4.

[56] CUB/100, Jenks-McGovern/28-29; NWIGU-ICNU/100, Smith/7-8.

demonstrate that shareholders have financed the prepaid pension asset. This approach is improper. As CUB and NWIGU-ICNU admit, ratemaking is imperfect,[57] and the fact that regulatory lag may create a differential between *actual* expense and the expense *estimated in rates* should not be determinative of whether a prepaid pension asset should be included in rate base.[58]

When rates are set, they account for the FAS 87 expense that is expected at the time.[59] In between rate cases, a utility's actual FAS 87 expense will differ from the amount estimated in rates.[60] This difference, however, cannot be isolated from other differences between the cost of service expected at the time of setting rates and the actual cost of service, and certainly does not suggest that rates in effect were not just and reasonable.[61] On the contrary, rates approved by the Commission are presumed reasonable unless and until the Commission changes those rates in a subsequent proceeding.[62] "Rates lawfully in effect are not revisited or 'trued-up' to match actual costs incurred" because "[s]uch true-up is retroactive ratemaking and retroactive ratemaking is prohibited, unless expressly authorized

[57] CUB/200, Jenks-McGovern/9; NWIGU-ICNU/100, Smith/24.

[58] NWIGU-ICNU/200, Smith/6. Indeed, NWIGU-ICNU recommends maintaining regulatory lag as an important incentive for utility management to control costs.

[59] *See, e.g.*, PAC/100, Stuver/2 ("PacifiCorp's practice has been to reflect in rates the FAS 87 expense determined by its actuaries for the applicable test periods, including any negative FAS 87 expense.").

[60] Order No. 08-487 at 7 ("like all forecasts, the utility's actual costs will vary"); *Hammond Lumber Co. v. Pub. Serv. Comm'n*, 96 Or. 595, 609 (1920) (the factors involved in ratemaking are "so many and so variable that it is impossible to fix rates that will be mathematically correct or exactly applicable to all the new conditions that may arise even in the immediate future").

[61] Joint Testimony/300, Joint Parties/9-10; *see also* Order No. 08-487 at 64 (rates are set holistically and individual components cannot be isolated from one another).

[62] *Re Portland General Elec. Co.*, Dockets UE 47/48, Order No. 87-1017, 1987 WL 257942 (Sept. 30, 1987) ("Rates thus constructed in rate cases are supposed to reflect the utility's future needs. Their reasonableness is measured by the rules of ratemaking employed in the case, not by the utility's later actual experience. Once the rates are properly made, the utility's actual experience under them is completely irrelevant to a determination of their reasonableness. Once the rate case is completed and the rates are permanent, they are conclusively presumed reasonable until changed again.").

by the Legislature."[63] Therefore, each utility's actual prepaid pension asset—based on actual contributions and actual FAS 87 expense—should be included in rate base.

Further, the standard proposed by CUB and NWIGU-ICNU is applied to no other rate base item.[64] When a utility requests recovery on an investment in plant, the Commission grants the request if it determines the investment was prudent; the Commission does not compare the unrecovered investment to the estimated depreciation expense that was used to set rates.[65] Indeed, "all rate base components, to at least some degree, are typically estimates in a future test year" and are not trued-up when determining the balance on which the utility earns a return.[66]

Moreover, CUB's claims that the individual utilities have over-collected FAS 87 expense are problematic. For example, CUB claims that between 1996 and 2002 NW Natural customers were "shortchanged" by \$6.2 million.[67] CUB's claim has two fatal flaws. *First*, it is impossible to determine what was "actually recovered in rates" for pension expense.[68] As discussed above, it is possible to determine only the pension expense that was *estimated* in rates. The amounts collected from customers will necessarily vary from the estimates used to set rates for any one particular expense and it is not possible to assign specific cost recovery to a specific estimated expense. *Second*, even if one assumes that the amount estimated in rates was actually recovered, CUB's claim is based on its biased selection of limited historical data.[69] In fact, analyzing the entire historical period demonstrates that NW Natural has *under-*

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[63] *Id.*

[64] Joint Testimony/600, Joint Parties/8.

[65] Joint Testimony/600, Joint Parties/8.

[66] *Re Portland General Elec. Co.*, Dockets UE 180/184, Order No. 07-454 at 6 (Oct. 22, 2007).

[67] *See, e.g.*, CUB/100, Jenks-McGovern/19.

[68] Joint Testimony/300, Joint Parties/10; Joint Testimony/600, Joint Parties/18; Order No. 08-487 at 64.

[69] *See, e.g.*, NWN/100, Wilson/6.

recovered FAS 87 expense by $3.8 million.[70] Likewise, since 1992 Avista estimates that is has under-recovered FAS 87 by approximately $2.4 million.[71] Thus, while the Joint Utilities do not agree that it is appropriate to deny recovery of financing costs because of concerns regarding regulatory lag, it must be noted that **in many cases regulatory lag related to FAS 87 has accrued to the benefit of customers**.

CUB also incorrectly claims that "[t]here is not a single company in this docket that flowed through rate relief to their customers when FAS 87 expense was [negative]."[72] In fact, both NW Natural's and PacifiCorp's rates have included customer credits associated with negative FAS 87 expenses.[73] And neither Avista nor Cascade has experienced negative FAS 87 that affected their Oregon jurisdiction, and therefore could not have passed negative FAS 87 expense on to their Oregon customers.[74]

Importantly, if individual utility circumstances call into question the prudence of historical activities, those questions should be addressed in utility-specific proceedings.

b. The Joint Utilities' Prepaid Pension Assets are the Result of Cash Contributions in Excess of FAS 87 Pension Expense.

Parties also argue that the prepaid pension asset was caused by greater-than-expected investment returns and negative FAS 87 expense[75] rather than utility contributions.[76] This argument is inaccurate.

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[70] NWN/100, Wilson/6 ("for the period from 1986 through 2010 the Company 'under-recovered' FAS 87 expense by approximately $3.8 million").

[71] Staff/102, Bahr/3.

[72] CUB/100, Jenks-McGovern/22; CUB/100, Jenks-McGovern/34 ("when pensions perform well, and FAS 87 expenses are negative, then the Companies keep all the proceeds").

[73] NWN/100, Wilson/9-10; PAC/100, Stuver/2.

[74] Staff/102, Bahr/2-5.

[75] CUB/100, Jenks-McGovern/14; CUB/100, Jenks-McGovern/32.

[76] Staff/100, Bahr/23.

First, CUB's concerns about greater-than-expected returns are misplaced. FAS 87 expense is calculated based on various assumptions, including expected market returns. Investment returns, including amounts in excess of what is expected, benefit customers by reducing both prospective FAS 87 expense and contributions.[77] Therefore, the value of historical investment returns, whether greater than expected or not, are accounted for when determining FAS 87 expense.

Furthermore, the prepaid pension asset is, by definition, the difference between the cash contributions and FAS 87 expense and this relationship remains true regardless of the level of investment returns earned by the pension plan and amortized through the FAS 87 expense.[78] If customers are providing recovery of FAS 87 expense and utilities are funding the contributions, then the difference between these two values represents the portion that is financed by the utilities.

CUB's concerns regarding the effect of negative FAS 87 expense are similarly misplaced. CUB claims that "[s]ignificant portions of the current prepaid pension assets[] that the Joint Utilities claim require a return[] come solely from negative FAS 87, money not financed by the utility, which was not passed through to customers."[79] To the contrary, the Joint Utilities have shown that the prepaid pension asset is overwhelmingly the result of contributions.[80] For example, the vast majority of NW Natural's prepaid pension asset has accrued since 2002, when the Company's FAS 87 expense has been consistently positive.[81] Indeed, NW Natural has had relatively few years of negative FAS 87 expense before 2002,

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[77] Joint Testimony/300, Joint Parties/8; Joint Testimony/400, Vogl/5-6; NWIGU-ICNU/100, Smith/14-15.

[78] Joint Testimony/400, Vogl 6.

[79] CUB/100, Jenks-McGovern/14; *see also* CUB/100, Jenks-McGovern/32 ("a significant portion of the asset grew out of negative FAS 87 that was not shared with customers").

[80] NWN/100, Wilson/9-10; PAC/100, Stuver/2-3.

[81] NWN/100, Wilson/9-10; Staff/102, Bahr/1.

which could not have contributed to its significant current prepaid pension asset.[82] Similarly, PacifiCorp has experienced only $22.6 million of negative FAS 87 since 1998, which is less than 10 percent of its prepaid pension asset as of the end of 2012.[83] Therefore, PacifiCorp's prepaid pension asset is also not the result of negative FAS 87 expense.[84] At the end of 2013, 73 percent of PGE's prepaid pension asset was the direct result of cash contributions since the enactment of the PPA.[85] As of the end of 2014, PGE's cash contributions since the enactment of the PPA exceed the balance of its prepaid pension asset.[86] And Avista's and Cascade's prepaid pension assets consist of utility contributions exclusively, because neither utility has experienced negative FAS 87 that affected Oregon rates.[87]

c. The Joint Utilities' Cash Contributions Were Prudently Made.

CUB recommends that the Commission presume that all cash contributions above the minimum amount required by law are imprudent.[88] There is no basis for this recommendation. Utility contributions above the minimum legal requirement are *for the benefit of customers.* Greater-than-minimum contributions reduce future FAS 87 expense and future cash contributions, and can improve a company's credit metrics to maintain or improve a company's credit rating, lower premiums paid to the Pension Benefit Guarantee Corporation (PBGC), provide tax benefits, help avoid future benefit restrictions, and may be required by a

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[82] NWN/100, Wilson/11.

[83] PAC/100, Stuver/3; Staff/102, Bahr/1.

[84] PAC/100, Stuver/3.

[85] PGE/100, Hager-Jaramillo/3-4; Joint Testimony/600, Joint Parties/17.

[86] Joint Testimony/600, Joint Parties/17.

[87] Staff/102, Bahr/2-5.

[88] CUB/300, Jenks-McGovern/17.

company's creditors.[89] Indeed, as Staff testifies, it may be imprudent for a utility to simply make its minimum required contribution without consideration of other factors.[90]

d. Historical Treatment of Accrued Pension Liabilities Does not Support Exclusion of the Prepaid Pension Asset from Rate Base.

NWIGU-ICNU claim that the Joint Utilities' request in this case should be rejected because accrued pension liabilities "have not routinely been reflected as rate base deductions in the past[.]"[91] Similarly, CUB claims that "each of the utilities sometimes have had a prepaid pension asset and at other times have had an accrued pension liability[.]"[92] This concern is off base. First, the evidence demonstrates that none of the Joint Utilities have maintained a *significant* accrued pension liability. NW Natural has never had an accrued pension liability.[93] Moreover, since 1998 PacifiCorp has had an average prepaid pension asset of $32 million.[94] And PGE has had an accrued liability in only six years since 1987 and has had an asset since 1997.[95]

Prospectively, the Joint Utilities agree that if their prepaid pension assets are included in rate base, any future accrued pension liabilities should be accorded the same treatment. However the treatment of past pension liabilities should not prevent the Commission from adopting the Joint Utilities' proposal.

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[89] Joint Testimony/600, Joint Parties/12.

[90] Staff/300, Bahr/9.

[91] NWIGU-ICNU/100, Smith/7.

[92] CUB/200, Jenks-McGovern/2.

[93] Staff/102, Bahr/1.

[94] PAC/100, Stuver/3.

[95] Staff/102, Bahr/1.

e. The Joint Utilities' Historical FAS 88 Expense Does Not Undermine Their Recommendation

CUB argues that most parties continue to ignore FAS 88 in claiming that FAS 87 will equal pension contributions over time.[96] The Joint Utilities have stated that pension expense will equal contributions over the life of the pension plan and that pension expense includes both FAS 87 and FAS 88 expense.[97] PacifiCorp, for example, has had significant FAS 88 expense in the past, which has been included in the calculation of and served to reduce PacifiCorp's prepaid pension asset. The basic principle remains that company contributions have exceeded pension expense, and it is this excess of contributions that creates the prepaid pension asset.

The following table, in millions, illustrates how PacifiCorp's FAS 88 expense serves to reduce the prepaid pension asset and has been properly included in the calculation of the prepaid pension asset.[98]

Prepaid Pension Asset as of 12/31/1997		Cumulative Contributions 1998 to 2013		Cumulative FAS 87 Expense 1998 to 2013		Cumulative FAS 88 Expense 1998 to 2013		Prepaid Pension Asset as of 12/31/2013
$(68.4)	+	$917.9	-	$356.9	-	$181.6	=	$311.0

CUB's claim that PacifiCorp has collected all but $196.2 million of their contributions rather than the $311 million prepaid pension asset as of December 31, 2013, is not due to PacifiCorp excluding FAS 88 from its prepaid pension asset calculation. The table above illustrates that PacifiCorp has actually reflected its FAS 88 expense in the determination of the prepaid

[96] CUB/400, Jenks-McGovern, 6-7.

[97] Joint Testimony/100, Joint Parties/9.

[98] The data in the table is sourced from CUB/106 and CUB/402.

pension asset. Rather CUB's claim is due to CUB's inaccurate assumption that the FAS 87 expense included in rates was the amount collected until the next rate case. As discussed further in this brief, CUB's net cash method is inconsistent with the calculation of all other rate base items. CUB also inaccurately claims that PacifiCorp has not explained its large FAS 88 expense; PacifiCorp has explained that those charges were associated with early retirement programs and the prudency of the charges was addressed in prior rate cases.[99]

2. The Joint Utilities Request Will Not Create the Inappropriate Incentives Claimed.

In addition to the utility-specific claims, both CUB and NWIGU-ICNU argue that granting the Joint Utility proposal will create the wrong incentives for the utilities. CUB claims that the inclusion of the prepaid pension asset in rate base would incent the utilities to "make additional contributions to its pension—even when the pension fund was overfunded[.]"[100] This is untrue. As a pension plan reaches fully funded status, a utility would actually be dis-incented from over-contributing because, upon termination of the plan, the excess assets would be subject to significant taxes.[101] NWIGU-ICNU point out that once contributions are made to the pension, those funds cannot be withdrawn or utilized for non-pension purposes—further dis-incenting the utilities from over-funding their plans.[102]

CUB also claims that allowing a return on the prepaid pension asset will incent the utilities to create a "perpetual profit machine," where the prepaid pension asset will grow indefinitely.[103] The prepaid pension asset, however, cannot grow indefinitely as CUB claims.

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[99] *See* CUB/104.

[100] CUB/100, Jenks-McGovern/22.

[101] Joint Testimony/100, Joint Parties/5; Joint Testimony/400, Vogl/9.

[102] NWIGU-ICNU/100, Smith/9. CUB also concedes that once funds are paid into the pension trust, they cannot be withdrawn. CUB/100, Jenks-McGovern/28.

[103] CUB/100, Jenks-McGovern/21-23.

Over the life of the pension plan the cumulative cash contributions will equal the cumulative FAS 87 and FAS 88 expense and as FAS 87 expense is incurred, the prepaid pension asset decreases.[104] Therefore, it is indisputable that the prepaid pension asset cannot grow indefinitely and will eventually reach a zero balance at the end of the pension plan's life.

NWIGU-ICNU also claim that allowing a return on prepaid pension assets will encourage the Joint Utilities to retain their pension plans and could deter cost effective plan management.[105] However, all of the Joint Utilities' pension plans are already in some form of closed or frozen status.[106] Moreover, the Commission retains authority at all times to review the prudence of utility compensation practices.

3. Allowing Prospective Recovery of Pension Financing Costs Does Not Constitute Retroactive or Single Issue Ratemaking.

At various times in this proceeding, parties have suggested that the addition of the prepaid pension asset to rate base would violate fundamental regulatory policies. Specifically, CUB has argued that the Joint Utilities' proposal would constitute retroactive ratemaking,[107] while Staff has suggested that the proposal would constitute single issue ratemaking.[108] There is no merit to either of these claims.

The prohibition on retroactive ratemaking prohibits the Commission from incorporating past profits or losses in future rates by either allowing a utility to (a) recoup past losses or (b) refund to customers excessive profits.[109] In other words, the Commission violates the rule

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[104] Joint Testimony/500, Joint Parties/19-20.

[105] NWIGU-ICNU/100, Smith/13-14.

[106] NWIGU-ICNU/100, Smith/12-13.

[107] CUB/100, Jenks-McGovern/27.

[108] Staff/100, Bahr/15-17.

[109] *Gearhart*, 356 Or. at 237.

against retroactive ratemaking where it sets future rates to account for historical over- or under-recovery of a utility's actual costs. The Commission applies this prohibition narrowly.[110]

The Joint Utilities' request does not implicate retroactive ratemaking. To be clear, the utilities have maintained significant prepaid pension assets for several years now and have been financing those assets all along. ***They are not seeking to recover those past financing costs.*** Neither are they seeking in this docket to modify future pension cost recovery to account for the difference between the historical FAS 87 amounts estimated and collected through rates and each company's actually-incurred FAS 87 expense.[111] These hypothetical requests *would* violate the rule against retroactive ratemaking, but are not at issue in this case. On the contrary, the Joint Utilities are simply requesting that their current prepaid pension assets be added to future rate base for the purpose of setting future rates.[112] As discussed above, this treatment is consistent with the Commission's treatment of other utility investment.[113]

Moreover, any concerns about single-issue ratemaking are premature at best. The Joint Utilities' proposal is that the prepaid pension asset be added to rate base in their next general rate cases. If this approach is taken, the Commission will have the opportunity to review all utility costs, and single-issue ratemaking will not be implicated. Moreover, if a utility requests that the prepaid pension asset be added to rate base in between rate cases, the Commission will have an opportunity to determine at that time whether the request is appropriate.

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[110] Order No. 08-487 at 40-41.

[111] Joint Testimony/300, Joint Parties/12. NW Natural has a balancing account that tracks the difference between its FAS 87 expense included in rates and its actual FAS 87 expense. Therefore, consistent with the Commission's approval of the balancing account, NW Natural will be seeking recovery of this difference in the future. *See* NWN/200, Wilson/2-4 (describing balancing account).

[112] Joint Testimony/300, Joint Parties/12.

[113] Joint Testimony/600, Joint Parties/16.

C. Staff's Recommendations for Return on Prepaid Pension Asset Should be Rejected.

Staff recognizes that utilities can incur real financing costs associated with a prepaid pension asset.[114] Despite this conclusion, Staff recommends that only the "prospective" prepaid pension asset be included in rate base.[115] In other words, Staff argues that cumulative differences between cash contributions and FAS 87 incurred to date should be ignored for regulatory purposes, and that utilities instead track a theoretical "prepaid pension asset" based on the fictitious assumption that none of the prepayments to pension plans made to date were actually financed by the utility. Staff's primary reason for this recommendation—its belief that inclusion of the current prepaid pension asset constitutes single-issue ratemaking—is addressed above. In addition, Staff's proposal should be rejected for the following technical and policy reasons.

First, Staff's position is illogical. If it is conceptually appropriate to include the prepaid pension asset in rate base, there is no reasonable basis to exclude the current prepaid pension asset. *Second*, Staff's recommendation will further exacerbate the problem that gave rise to this docket by effectively prohibiting the utilities from recovering the financing costs of their prepaid pension assets. By definition, over the life of the pension plan, the cumulative cash contributions will equal the cumulative FAS 87 expense. The fact that the Joint Utilities all have prepaid pension assets today means that the cumulative cash contributions have exceeded the cumulative FAS 87 expense. Prospectively, then, the cumulative FAS 87 expense will exceed the cumulative cash contributions in order for the two values to be equal at the end of the plan. Therefore, under Staff's proposed artificial accounting, the Joint Utilities would have an accrued pension liability for regulatory purposes even though in actuality they will have a prepaid pension asset.[116] Staff's proposal is akin to removing the

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[114] Staff/300, Bahr/2.

[115] Staff/100, Bahr/22.

[116] Joint Testimony/400, Vogl/2-5; Joint Testimony/300, Joint Parties/7.

investment in property, plant, and equipment from rate base, but including in rate base its associated accumulated depreciation. That approach is patently unfair.

Staff agrees that the Joint Utilities are incurring a real cost to finance the prepaid pension asset, so a proposal that prohibits recovery of that cost and actually requires the Joint Utilities to artificially reduce rate base is entirely unreasonable. By severing the actual relationship between FAS 87 expense and cash contributions, Staff's recommendation departs from well-established accounting principles.[117]

Staff also recommends that greater-than-expected returns be excluded from the prepaid pension asset included in rate base.[118] As we have explained above, Staff's concerns regarding "excess returns" are unfounded. Moreover, Staff's recommendation adds unreasonable complexities and it is unclear how the Joint Utilities would actually implement the recommendation. Staff does not address the fact that if some portion of investment returns is removed from the prepaid pension asset, then there would need to be a corresponding adjustment to prospective FAS 87 expenses.[119]

Staff's proposal also fails to account for the effect of returns *below* the expected rate of return or the corresponding impacts to FAS 87 expense.[120] If greater-than-expected returns are removed from the prepaid pension asset, then less-than-expected returns should result in an upward adjustment to the prepaid pension asset, which would cause the prepaid pension asset included in rate base to deviate even further from the prepaid pension asset included on each utility's books.

Staff offers an alternative proposal, recommending that only the portion of the current prepaid pension asset that has accrued since 2008 be included in rate base, thereby limiting

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[117] Joint Testimony/300, Joint Parties/8.

[118] Staff/100, Bahr/23.

[119] Joint Testimony/400, Vogl/6; NWIGU-ICNU/200, Smith/10.

[120] Joint Testimony/300, Joint Parties/7.

(although not eliminating) the historical review of each utility's prepaid pension asset. Additionally, as in its primary recommendation, Staff proposes that the prepaid pension asset balance exclude amounts attributable to excess investment returns and be netted down by the proportionate amount of accumulated deferred taxes.[121] Staff's alternative proposal suffers from the same conceptual and practical flaws as Staff's primary recommendation.

D. The Commission Should Affirm the Use of FAS 87 Expense to Recover Pension Costs.

All of the parties agree that FAS 87 is a reasonable basis for setting rates, and all the parties except CUB recommend that the Commission continue to use FAS 87 expense.[122] FAS 87 expense is well-suited to ratemaking because it acts to smooth the volatility that is inherent in the Joint Utilities' cash contributions. FAS 87-based recovery has also worked well historically and has remained relatively consistent over time. With the addition of the financing costs the Joint Utilities incur to finance their cash contributions, the use of FAS 87 expense allows the Joint Utilities a reasonable opportunity to recover all of their pension costs.[123] Given these reasons and the parties' consensus, the Commission should reaffirm the continued use of FAS 87 expense to set rates.

Moreover, if the Commission is inclined to switch to a cash recovery method, ***there must be a transition to allow for a full recovery of the prepaid pension asset.***[124] Importantly, under a continuation of FAS 87-based recovery, each company's existing prepaid pension asset would be recovered over time through FAS 87 expense.[125] This fact is not in

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[121] Staff/100/Bahr 24. In this alternative, Staff also proposes that the prepaid pension asset balance would be subject to a true-up of pension costs in rates and actual FAS 87 expense and be subject to a rate of return that is lower than the authorized rate of return.

[122] Joint Testimony/600, Joint Parties/1-2; CUB/300, Jenks-McGovern/4.

[123] Joint Testimony/500, Joint Parties/15-16.

[124] Joint Testimony/500, Joint Parties/9-12.

[125] Joint Testimony/500, Joint Parties/9.

dispute.[126] If the Commission fails to allow for full recovery of the prepaid pension asset in a transition to a cash-based recovery, the Joint Utilities would be required to write off the full amounts of their prepaid pension assets. As Staff recognizes, such significant write-offs would very likely have a detrimental effect on the utility's stock value and credit rating, resulting in severe damage to the utility.[127]

If the Commission is inclined to transition to cash-based pension cost recovery, it should allow the Joint Utilities to recover their current prepaid pension assets over a five-year period, with the unrecovered balance earning a return at each company's authorized rate of return.[128] Amortizing the prepaid pension asset over time will lessen the immediate rate impact of the transition and is consistent with the regulatory principle of gradualism.[129] In addition, the Commission should use either a three- or five-year average of forecast cash contributions to estimate the amount of pension costs that will be included in rates, and allow the Joint Utilities to create a balancing account to track the differences between the pension costs estimated in rates and each company's actual cash contributions.[130] Both the use of the multi-year average and the balancing accounts address the volatility that is inherent when using cash contributions to set rates and are necessary to ensure just and reasonable rates.[131]

CUB's primary recommendation is that the Commission disallow recovery of all of the Joint Utilities' prepaid pension assets as part of the transition to cash.[132] In the alternative,

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[126] *See, e.g.,* CUB/300, Jenks-McGovern/4.

[127] Staff/300, Bahr/14.

[128] Joint Testimony/500, Joint Parties/11-12.

[129] Joint Testimony/500, Joint Parties/11.

[130] Joint Testimony/500, Joint Parties/12-13.

[131] Joint Testimony/500, Joint Parties/14.

[132] CUB/300, Jenks-McGovern/30.

CUB proposed a "Net Cash Method" that could be used to determine the amount of the prepaid pension asset that would be recovered as part of the transition.[133] The Net Cash Method purports to determine the amount of each company's prepaid pension asset that was funded by shareholders by calculating the prepaid pension asset as the difference between each company's prudent cash contributions and the amount of pension expense that was actually recovered in rates.[134] For many of the reasons already discussed above, CUB's Net Cash Method is flawed and based on unreasonable assumptions. First, CUB assumes that the pension expense estimated in rates was the pension expense recovered in rates, even though such an assumption is inconsistent with basic ratemaking principles.[135] In addition, even if the assumption were true, the facts suggest that the pension expense estimated in rates was consistently less than many utilities' actual pension expense.[136]

Second, CUB's presumption that it is imprudent for utilities to make cash contributions over the legally required minimum is completely without support in the record and ignores the numerous customer benefits resulting from greater cash contributions.[137]

Third, CUB's proposal to limit prospective pension cost recovery based on a true-up of historical pension cost recovery, is illegal retroactive ratemaking.[138]

IV. CONCLUSION

The Commission should affirm the continued use of FAS 87 expense to set rates and adopt a policy to allow the Joint Utilities include their prepaid pension assets in rate base at their authorized rate of return, subject to the appropriate utility-specific ratemaking

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[133] CUB/300, Jenks-McGovern/17-18.

[134] CUB/300, Jenks-McGovern/17-18.

[135] Joint Testimony/300, Joint Parties/10; Joint Testimony/600, Joint Parties/18; Order No. 08-487 at 64.

[136] *See* NWN/100, Wilson/6; Staff/102, Bahr/3.

[137] Joint Testimony/600, Joint Parties/19.

[138] Joint Testimony/600, Joint Parties/19; Order No. 08-487 at 40-41.

proceedings that will follow this investigation. Including the prepaid pension asset in rate base is consistent with general principles of ratemaking and with the treatment of prepaid pension assets in numerous other jurisdictions. The parties criticisms of the Joint Utilities' proposal are either incorrect or improper for this phase of the investigation and should therefore be rejected.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in Docket UM 1633 on the following named person(s) on the date indicated below by email addressed to said person(s) at his or her last-known address(es) indicated below.

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