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April 24, 2015

Via Electronic Filing

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 Response Brief 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,

/s/ Jesse O. Gorsuch
Jesse O. Gorsuch

Enclosure

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.	))))))))	RESPONSE BRIEF OF THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES AND THE NORTHWEST INDUSTRIAL GAS USERS

I. INTRODUCTION

The Joint Utilities'[1/] opening brief presents the issue in this docket as a simple matter of investor compensation. Investors, they argue, have contributed capital to the Joint Utilities' pension plans for which they should earn a return. Thus, the Commission should allow them to include their "prepaid pension assets" in rate base.[2/]

The Joint Utilities' "simple"[3/] proposal, however, would upset a decades-old balance between investors and customers. Customers fund the Joint Utilities' pension plan by paying in rates expenses determined under Financial Accounting Standard ("FAS") 87, an accrual method of accounting that does not match annual pension-related contributions (but will achieve this match at the end of the pension plan). For most of the Joint Utilities, at certain points in the past, FAS 87 expense has exceeded total contributions to the pension plan. In this circumstance, the Joint Utilities carried an "accrued pension liability" on their books – capital

1/ The Joint Utilities are Avista Corp., Cascade Natural Gas Corp., Northwest Natural Gas Co. ("NW Natural"), Portland General Electric Co. ("PGE"), and PacifiCorp d/b/a Pacific Power ("PacifiCorp").
2/ Joint Utilities' Opening Br. at 2.
3/ Id. at 1.

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that customers provided to the utility. At other times in the past, total contributions to the pension plan have exceeded FAS 87 expense. These contributions may have been made up by investors (although not necessarily),[4/] and resulted in a "prepaid pension asset" on the Joint Utilities' books. In neither circumstance have customers or investors earned a "return" (for customers, in the form of reduced rate base) on the capital they provided.

Now that the Joint Utilities each carry a prepaid pension asset on their books, they seek to provide such a return to their investors by arguing that these prepaid pension assets are unreasonably large and likely to stay that way for an unreasonable amount of time. The evidence in this docket, however, does not support that contention. Instead, the consequence of the Joint Utilities' proposal will be to upset the historical balance of pension funding, create asymmetrical pension cost recovery, and give the Joint Utilities sole control over the amount included in rate base of an accounting item with a highly variable and unpredictable value. The Joint Utilities' proposal is anything but "simple." It does not appropriately balance the interests of investors and customers, and therefore, should be rejected.

II. ARGUMENT

A. The timing of the Joint Utilities' request to include their prepaid pension assets in rate base upsets the balance between investors and customers that the Commission's current policy maintains.

ICNU/NWIGU's primary objection to the Joint Utilities' request to include their prepaid pension assets in rate base is one of timing. The Joint Utilities' request to include their prepaid pension assets in rate base now, after years in which those assets (and liabilities) were not included in rate base and fluctuated between positive and negative amounts, is unfair to

4/ ICNU/NWIGU Prehearing Memorandum at 18-19; Staff Prehearing Memorandum at 10; CUB Prehearing Memorandum at 34.

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ratepayers and does not recognize the long-term effects of pension accounting in which these prepaid pension assets will, by definition, reduce to zero.[5/]

The law requires the Commission to "balance the interests of the utility investor and the consumer in establishing fair and reasonable rates."[6/] The Joint Utilities' proposal, by focusing solely on the investor interest, does not achieve the necessary balance. Indeed, absent from the Joint Utilities' proposal and supporting testimony is any discussion of how it may benefit ratepayers. The one-sided nature of the proposal is most evident from the fact that the only utility that has asked to be excused from this proceeding is the only one that currently has an accrued pension liability, Idaho Power.[7/] Under this scenario, Idaho Power customers would continue to pay FAS 87 in rates while being denied the rate base benefits of the accrued pension liability, while customers of all other Oregon electric and natural gas utilities would pay FAS 87 expense in addition to a return on the prepaid pension asset. It is difficult to think of a more asymmetrical policy.

The Joint Utilities criticize the Commission Staff's analogy of their request in this docket to a deferral filing,[8/] but there are important similarities in the way they both represent a one-sided modification to the regulatory compact. In the vast majority of cases, utilities use deferral filings to capture costs incurred between rate cases. Customers do not control the timing of these filings, nor do they have the information or resources necessary to make offsetting filings capturing the benefits utilities also realize between rate cases. Rather, customers must rely on the general rate case process to establish an overall just and reasonable revenue

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5/ Joint Testimony/200 at 11:19-20.
6/ ORS § 756.040(1).
7/ Docket No. UM 1633, Idaho Power's Reply Brief on Bifurcation Proposal at 2-4 (June 21, 2013).
8/ Joint Utilities' Opening Br. at 8.

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requirement for the utility that accounts for *all* costs and benefits. Similarly with the Joint Utilities' pension accounting, the history of this accounting since the implementation of FAS 87 has shown periods where a prepaid pension asset is present and others with an accrued pension liability.[9] Over time, the net effect of these fluctuations is for FAS 87 expense to equal pension expense.[10] Selecting a particular point in time when the Joint Utilities have (or had, when this docket was first opened) unusually large prepaid pension assets upsets this balance and creates asymmetrical recovery. Had ICNU or CUB, for instance, requested that PacifiCorp include its accrued pension liability in rate base when it was valued at over $60 million,[11] the utility surely would have objected.

While the Joint Utilities do attempt to justify the timing of their request, their reasons are not convincing. The Pension Protection Act and the 2008 market crash has resulted in "larger and more sustained prepaid pension assets," the Joint Utilities argue, and therefore, they have "demonstrated that growth in prepaid pension assets is not temporary."[12] The evidence does not support this claim. Two of the Joint Utilities had prepaid pension asset balances at the end of 2014 that were *less* than such balances in 2007, before implementation of the Pension Protection Act and the 2008 market crash.[13] This indicates that the changes in funding requirements necessitated by the Pension Protection Act do not necessarily result in higher and more sustained prepaid pension asset balances. Meanwhile, it is not credible to

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9/ Staff/100 at 6 (table 1).

10/ Joint Testimony/200 at 11:19-20.

11/ PAC/100 at 3:11-12.

12/ Joint Utilities' Opening Br. at 13.

13/ PGE's 2014 prepaid pension asset balance was $49.8 million, down from $82 million in 2007. Northwest Natural's 2014 prepaid pension asset balance was $21.5 million, down from $21.9 million in 2007. Compare Staff/100 at 6 (table 1) with Staff/503 and Staff/505 (pursuant to conversations with PGE and NW Natural, the information in Staff/503 and Staff/505 is no longer confidential).

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suggest that the effects of the 2008 market crash are essentially permanent. The economy has recovered substantially from this period, with the stock market reaching record-high levels.

The Joint Utilities also have provided no evidence in this docket to demonstrate that their failure to earn a return on their prepaid pension asset balances has harmed their credit ratings, access to capital, or otherwise resulted in unjust or unreasonable rates, or that their failure to do so in the future will have such an effect. Nor have the Joint Utilities grappled with how the effect of any prepaid pension asset may have been reduced by lower costs or increased benefits of other aspects of their operations. As the Utah Public Service Commission stated when examining this issue, a "claim that shareholders' funds have been used without compensation must be judged by an earnings, not a single-item accounting, test."[14/] Similarly, the Connecticut Department of Public Utility Control has determined when it examined this issue, the utility's "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."[15/] Without some showing that the Commission's current policy deprives investors of a reasonable return on their overall investment in the utility, the potential for harm to customers from the Joint Utilities' proposal should outweigh the interests of their investors.

[14/] In re U.S. West Commc'ns, Inc., Docket No. 97-049-08, 183 P.U.R.4th 382 at *8 (Dec. 4, 1997).

[15/] In re Conn. Light & Power Co., Docket No. 03-07-02, Final Decision at 150 (Dec. 17, 2003). The Joint Utilities' Opening Brief argues that ICNU/NWIGU's reliance on U.S. West and Conn. Light & Power is misplaced because those cases presented different factual scenarios than in this docket; however, the factual distinctions noted by the Joint Utilities do not render these commissions' ratemaking policy determinations any less applicable in this docket.

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B. The prepaid pension asset is not a traditional rate base item.

The Joint Utilities' justification for including the prepaid pension asset in rate base is that it compensates their investors for capital they have contributed to these pensions.[16/] It is not at all clear, however, that including the prepaid pension asset in rate base would actually accomplish this goal. Rather, there is the significant possibility that including the prepaid pension asset in rate base would overcompensate investors by an unreasonable amount.

The Joint Utilities argue that the prepaid pension asset is like "many items included in rate base [that] can change value from year to year and do not depreciate in the same way as traditional utility plant."[17/] But the Joint Utilities' analogy to other such items highlights the important differences between these items and the prepaid pension asset.[18/] Cash working capital, for instance, while not constant, is relatively predictable and is included in rate base as an average value that is objectively determined through a lead-lag study or other methodology.[19/] Similarly for materials and supplies, these costs can be reasonably predicted and are included in rate base on an average basis.[20/] On the other hand, the large historical fluctuations in the prepaid pension asset – including its occasional conversion to an accrued pension liability – demonstrate that this asset is not reasonably predictable.[21/]

Moreover, the Joint Utilities are not proposing that the prepaid pension asset be included in rate base as an average value, but at its actual value at the time the utility files its

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16/ Joint Utilities' Opening Br. at 2.

17/ Id. at 11.

18/ Id.

19/ James C. Bonbright et al., Principles of Public Utility Rates, 242-44 (2d ed. Pub. Utils. Rep. 1988). PGE recently performed an updated lead-lag study as part of a settlement in its 2014 general rate case, for instance. Docket No. UE 283, Order No. 14-422, App. A at 3 (Dec. 4, 2014).

20/ Bonbright, Principles of Public Utility Rates at 244.

21/ See Staff/100 at 6 (table 1).

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next general rate case.[22/] Not only does this give the Joint Utilities the ability to unilaterally select the value of the prepaid pension asset included in rate base (by selecting the timing of their rate case filings), it also raises the significant possibility that the amount included in rate base will not appropriately reflect the prepaid pension asset's subsequent value in years between rate cases.

The central concern continues to be one of timing. Unlike working capital and supplies, the prepaid pension asset can fluctuate from positive to negative in a matter of a few years. Hence, the timing of when that asset is included in rate base matters immensely. When the Commission first opened this docket, PGE had a $108 million prepaid pension asset.[23/] Today, it has shrunk by over $50 million.[24/] The utility forecasts a further $30 million reduction, to a prepaid pension asset balance of $18 million, by the end of 2015.[25/] This $90 million reduction in PGE's prepaid pension asset over a 3-year period represents a little under one-third of the total capital cost the utility projected for its newly built peaking capacity resource, Port Westward 2.[26/]

Including the prepaid pension asset in rate base, in other words, will have a material impact on the rates customers pay, and between rate cases, those rates may include compensation for investors that has no relation to the level of funds investors provided to the pension plan. This demonstrates that the prepaid pension asset is fundamentally different from other rate base items, and that its inclusion in rate base raises serious equity concerns.

22/ Joint Utilities' Opening Br. at 3.

23/ Joint Testimony/100 at 11:5-6.

24/ Compare Joint Testimony/100 at 11:5-6 with Staff/505 (note that pursuant to conversations with PGE, Staff/505 has been de-designated as confidential). Furthermore, the utility's most recent Form 10-K indicates that it does not expect to contribute to its pension plan through 2019. PGE 2014 Form 10-K at 55.

25/ Docket No. UE 294, PGE/500 at 34:6-7.

26/ Docket No. UE 283, PGE/400 at 24:3.

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C. The Commission should avoid single-issue ratemaking in this case.

The Joint Utilities argue that their request does not constitute single-issue ratemaking because they only request a policy determination in this docket and that the ratemaking effects of that policy determination would only be implemented in a subsequent rate case.[27/] As ICNU/NWIGU showed in their prehearing memorandum, however, a Commission order that categorically allows the Joint Utilities to include their prepaid pension assets in rate base, without any independent showing that this treatment is necessary for just and reasonable rates in a subsequent rate case, would constitute single-issue ratemaking.[28/] This is because the Commission would be making a *de facto* ratemaking determination in this docket and would be doing so without considering the full picture of the utility's costs and revenues.

Thus, while for the reasons expressed elsewhere in this brief and their prehearing memorandum ICNU/NWIGU recommend that the Commission reject the Joint Utilities' request and continue its current policy of allowing only FAS 87 expense in rates, if the Commission believes a change in policy may be warranted, it should find that inclusion of the prepaid pension asset in rate base is only appropriate upon a showing by the utility in its next general rate case that such treatment is necessary for just and reasonable rates. As noted above, some of the Joint Utilities had higher prepaid pension asset balances in prior years than they have today and still enjoyed reasonable rates of return, strong credit ratings, and adequate access to capital. Moreover, none of the Joint Utilities has provided any evidence to suggest that their current prepaid pension asset balances are threatening their credit ratings, access to capital, or ability to earn a reasonable return.

27/ Joint Utilities Opening Br. at 7.

28/ ICNU/NWIGU Prehearing Memorandum at 8-11.

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D. The Joint Utilities have the burden of proof in this docket.

The Commission opened this investigation to determine whether the inclusion of the prepaid pension asset "in rate base is an appropriate policy …."[29/] The Joint Utilities argue that they do not have "the burden of persuasion in this case to demonstrate that their proposal to include the prepaid pension asset in rate base results in just and reasonable rates."[30/] As the proponents for a change in existing Commission policy that will be decided in this docket, however, the Joint Utilities do have the burden to demonstrate that including the prepaid pension asset in rate base is "an appropriate policy."[31/] While this may not require the Joint Utilities to demonstrate that a particular revenue requirement recovered through filed tariffs is just and reasonable in this docket, the rate implications of including the prepaid pension asset in rate base cannot be separated from an evaluation of the merits of such a policy change. The very basis for the Joint Utilities' request is to increase the revenue they collect from customers. Thus, the Joint Utilities must demonstrate that increasing customer rates (whatever that amount may end up being in a general rate case) by allowing a return on an additional rate base item best balances the interests of investors and customers with respect to the Joint Utilities' pension costs.[32/]

The Joint Utilities claim that ICNU/NWIGU have established a "Catch-22" by arguing that the Joint Utilities have all operated with "fair and reasonable" rates since 2008 (when the triggering events allegedly necessitating rate base treatment of the prepaid pension asset occurred), and therefore, have not met their burden to show that a change in policy is

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29/ Docket No. UG 221, Order No. 12-437 at 23 (Nov. 16, 2012).

30/ Joint Utilities' Opening Br. at 16.

31/ 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).

32/ ORS § 756.040(1).

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warranted.[33] The Joint Utilities argue that this position "would effectively prohibit the Commission from ever changing policies."[34] But that is not the case. The basis of ICNU/NWIGU's argument is that there is no evidence in this docket to suggest that inclusion of the prepaid pension asset in rate base is necessary to fairly compensate investors such that a balancing of investor and customer interests warrants rate base treatment of the prepaid pension asset. Such treatment has not been necessary for fair and reasonable rates in the past, where prepaid pension asset balances have been near, or even above, current levels. Moreover, contrary to the Joint Utilities' testimony, the evidence does not demonstrate that their prepaid pension assets are likely to continue to grow for the indefinite future, and there is no evidence that these balances are threatening any of the Joint Utilities' credit ratings or, indeed, that the rating agencies even consider these balances to be significant. It is difficult to understand, for instance, why PGE would need to include an $18 million prepaid pension asset in rate base when it was successfully operating with a $108 million prepaid pension asset outside of rate base. Indeed, even in instances where a utility's prepaid pension asset balance appears to be large, it is important to recognize that these balances are significantly offset (in some cases by as much as half) by the associated deferred tax benefit.[35]

As discussed above, there are serious timing issues associated with including the prepaid pension asset in rate base that create the possibility for asymmetrical recovery; and the Joint Utilities have not shown that rate base treatment of the prepaid pension asset is necessary

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[33] Joint Utilities' Opening Br. at 10.
[34] Id.
[35] See Staff/500 through Staff/505.

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for just and reasonable rates. Therefore, the Joint Utilities have not met their burden to demonstrate that their proposal represents "an appropriate policy."

III. CONCLUSION

For the foregoing reasons, ICNU/NWIGU urge the Commission to reject the Joint Utilities' proposal to include their prepaid pension assets in rate base. If the Commission does not reject the Joint Utilities' proposal outright, it should require each of the Joint Utilities to demonstrate in its next general rate case that including the prepaid pension asset in rate base is necessary to provide their investors with adequate compensation for the capital they have provided to the utility as a whole (as opposed to only the utility's pension plan), and thus, is necessary to establish fair and reasonable rates.

Dated this 24th day of April, 2015.

Respectfully submitted,

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