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	)
	)

OPENING TESTIMONY

OF THE

CITIZENS' UTILITY BOARD OF OREGON

September 25, 2014

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	OPENING TESTIMONY OF THE CITIZENS' UTILITY BOARD OF OREGON

I. Introduction

Our names are Jamie McGovern and Bob Jenks. Our qualifications were provided earlier in this docket as CUB Exhibit 101.

CUB files its Opening Testimony today pursuant to the Prehearing Conference Memorandum dated July 10, 2014,[1] issued by Chief Administrative Law Judge (ALJ), Michael Grant. That memorandum notified the parties that the Commission wished for them to address the following question in the Simultaneous Opening testimony to be filed on September 25, 2014:

[1] http://edocs.puc.state.or.us/efdocs/HDC/um1633hdc16616.pdf

> If the Commission decides to transition to the use of cash contributions to account for pension expense on a going forward basis, then what recommendations do you have to address the existing prepaid pension assets, the transition period, the mechanism to recover the cash contributions, and the mechanism to implement the transition?

CUB responds to that question in this Opening Testimony.

CUB proposed shifting to accounting for pensions on a cash basis in PGE's 2013 rate case.[2] PGE had proposed earning a return on its prepaid pension asset (PPA) and CUB's examination of that issue led it to the conclusion that ratemaking for pensions would be simpler, and easier to track, if the accounting was done on a cash basis, using cash contributions as the basis for ratemaking. Such a system would be preferable to FAS 87 because FAS 87 is difficult to forecast and FAS 87 is disconnected with the timing of cash contributions.[3]

PGE's response to CUB's 2013 rate case pension proposal was that converting to cash-based accounting would cause a massive write-off which would adversely affect the Company.[4]

CUB has not advocated for shifting to cash-based accounting since the filing of its PGE testimony; however, CUB does continue to believe that cash-based pension accounting (i.e. using cash contributions as the basis for ratemaking) would be preferable for Oregon.

CUB is encouraged by the Commission's request to all parties to examine the changes that would be necessary to implement such a transition and its request for parties to make:

[2] UE 262/CUB/100/Jenks/15.
[3] UE 262/CUB/102/Jenks.
[4] UE 262/PGE/1800/Hager-Jaramillo/14.

> recommendations . . . to address the existing prepaid pension assets, the transition period, the mechanism to recover the cash contributions, and the mechanism to implement the transition.[5]

CUB's Opening Testimony in this docket examines the transition that would be necessary to switch to ratemaking based on cash contributions. CUB attempts to be comprehensive in considering the options for transition, including identifying options that CUB does not itself support.

II. Background.

A. Making the Company Whole for the Full Pension Cost – Methodology Changes Could Create Risk Of Over Or Under Compensation

The Commission's questions to the parties have been posed in the context of the request from the utilities for a return on the prepaid pension asset that has, according to the utilities, ballooned since the Pension Protection Act of 2006 and the recession.[6] CUB's Opening Testimony will review, in terms of the prepaid pension asset, how to make a transition to cash-based regulatory treatment for pensions in a manner that fairly balances the interests of customers and utilities. Other parties have posited that over time, if played out to the end of time, the sum of all cash contributions are equivalent to the sum of all pension expense (FAS 87 expense and FAS 88 expense included), and that it is the difference in timing between the contribution (cash accounting) and pension expense (accrual accounting) that creates the burden on the companies. This simplistic explanation misses a significant piece of the puzzle. It is not that FAS 87 expense and

[5] http://edocs.puc.state.or.us/efdocs/HDC/um1633hdc16616.pdf
[6] UM 1633/Joint Testimony/200/Vogl/7-12.

cash contributions are designed to equal each other over time, rather it is the relationship of FAS 87 expense and cash contributions to the full pension cost.

By definition, the cumulative total of all cash contributions composes the full pension cost (FPC).

$$\sum_{beginning\ of\ transition}^{end\ of\ pension\ life} cash\ contributions = FPC$$

But the FPC is just a final value (and can be put into present value terms) and hence, can be attained by other methods. In particular, annual pension expense, based on accrual accounting methods, can be tallied to calculate the full pension cost independently.

$$FPC = \sum_{beginning\ of\ transition}^{end\ of\ pension\ life} pension\ expense$$

or

$$FPC = \sum_{beginning\ of\ transition}^{end\ of\ pension\ life} FAS\ 87 + FAS\ 88$$

Therefore, one can see that the full pension cost can be calculated by either cumulative pension expense or cash contributions. That is, the utilities could be made whole by reimbursing them for their actual cash contributions, which comprise the full pension cost, or they could be made whole for the full pension cost by reimbursing them, over the life of the pension for cumulative pension expense. Reimbursements on a cash basis, or on an accrual basis, are both reasonable approaches to making the company whole. They both have strengths and weaknesses, and neither system is perfect. Maintaining consistently the current method of recovery, based on FAS 87 expense, would, over time, accurately and effectively make the utility whole for the FPC. However, combining the

two reimbursement methods is what creates a risk of over-compensating or under-compensating the each utility.

B. The Risks And Inconsistencies That Transition Could Pose

Switching in mid-stream, as the Commission is currently considering, runs the risk of creating over or under compensation of the prepaid pension asset. One significant issue is the timing of a transition. Recall the comparison of year end PPA 2012 and 2013 from Staff's testimony:[7]

[7] UM 1633/Staff/200/Bahr/10.

Utility	Prepaid Pension Asset Balance as of December 31, 2012 (millions)	Prepaid Pension Asset Balance as of December 31, 2013 (millions)	% change
Pacific Power	$282.4	$310.9	10.1%
NW Natural	$35.4	$25.2	-28.8%
Portland General Electric	$108.0	$76.6	-29.1%
Avista	$62.9	$80.7	28.3%
Cascade Natural Gas	$15.1	$17.7	17.2%
Idaho Power		-$28.8	
Total		**$482.3**	

So how would fairness have been affected if the Commission had, with the anticipation of moving to cash recovery going forward, awarded the utilities the return of their full prepaid pension asset in 2012 versus 2013? How would that question be answered if the comparison was for 2014 versus 2015? The impact would be different for each utility. For example, if the Commission had decided to award PGE $108 million in 2012 (the full value of the prepaid pension asset) and the Commission had then required PGE to switch to cash recovery going forward, the amount recovered would have been $31.4 million more than if the Commission had made the award of the full value of the prepaid pension asset in 2013 when it would have been only $76.4 million. PGE did not make a contribution to its pension plan in 2013,[8] so on a going forward basis, PGE would have recovered cash contributions in an identical manner. If the transition analysis was done in 2012 and the new policy was implemented in 2013, customers would have over-compensated PGE by more than $30 million.

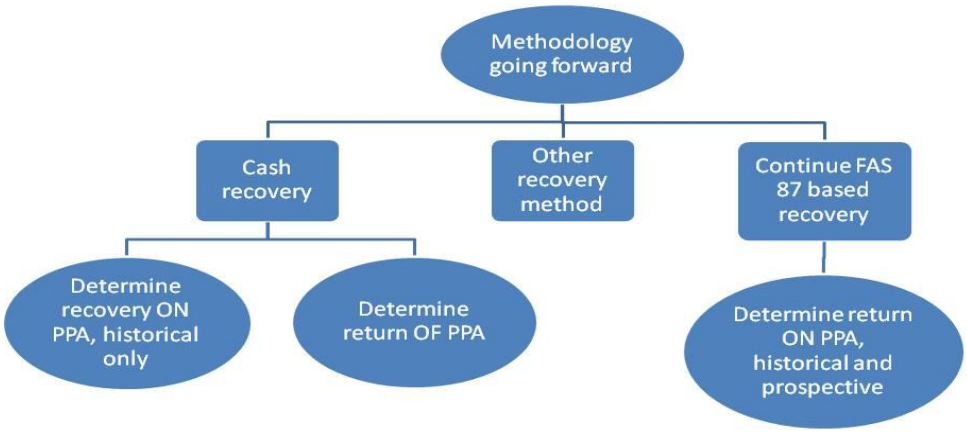
The issues discussed above only exist because of the transition from one ratemaking methodology to another ratemaking methodology. These issues would not

[8] UM 1633/CUB/ 107/Jenks-McGovern.

exist if the Commission continued to use FAS 87 based ratemaking recovery. Because of this, CUB thinks that it is important to point out that it is the transition from one accounting method to another that is necessitating consideration of the appropriateness of ratepayers having to pay the utilities additional recovery for the amount of the prepaid pension asset.

In CUB Figure 1, below, CUB presents a flow chart of the decision tree dilemma facing the Commission. Oval nodes are decision nodes. CUB believes that upon arrival at any of these decision nodes the Commission makes a choice that leads parties down a unique path.

CUB Figure 1:



But as discussed above, in order to know which decision tree branch to follow, one must understand the link between switching to cash-based recovery and the effect on the utilities. If the utilities were to maintain the current method of recovery (based on annual FAS 87 expense), then within that given regulatory structure, the utilities can reasonably expect to recover their cash contributions over time (assuming that there is not

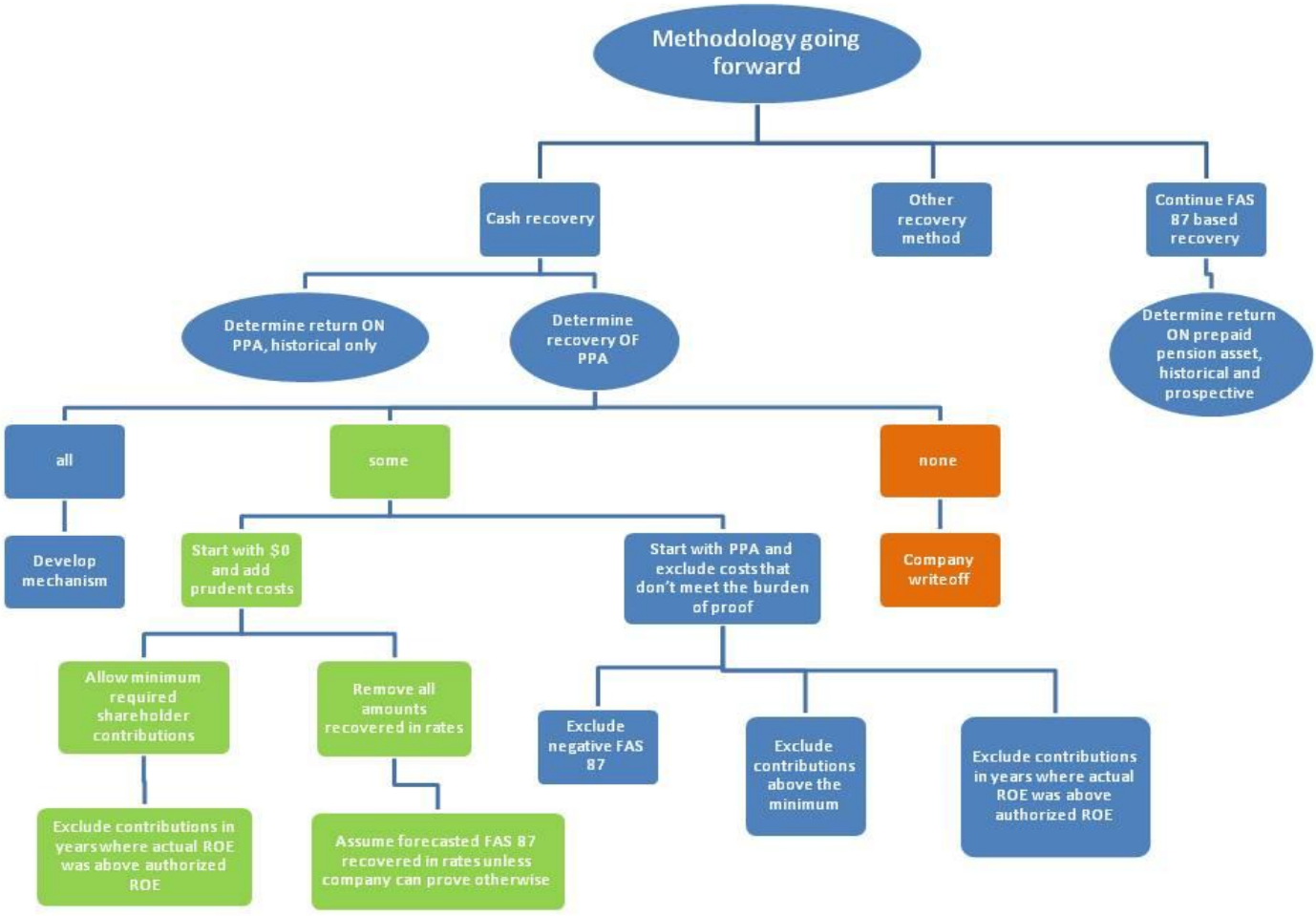
a large FAS 88 charge at some later date). CUB believes that this is a salient point to discuss because this means that it is not the current state of affairs, or even the existence of the prepaid pension asset, that would cause the utilities to request the return of the prepaid pension asset. It is specifically the change in regulatory methodology that will incent this need for treatment of the current prepaid pension asset balance. With this, it becomes clear that the advantages and flaws of both accrual and cash recovery merit discussion, especially since both methods of recovery are reasonable. CUB takes up this discussion later in the testimony. First, we try and get a more detailed and accurate picture of the options before the Commission.

III. Options For Transitioning to a Cash Basis for Regulatory Treatment of Pensions

A. The Decision Tree, As CUB Sees It

As discussed above, CUB thinks an understanding of the Commission decision tree is important. In this section we attempt to put some leaves on the bare decision tree branches.

CUB Figure 2:



In CUB Figure 2, above, CUB believes that the decision node in level 3 "Determine recovery OF PPA" is (1) directly determined by the choice to move to Cash recovery and (2) is unnecessarily narrow in scope. CUB believes that the approach to "determine recovery OF the prepaid pension asset" opens up a set of further decisions aimed at ensuring a fair transition.

B. Moving Between Two Reasonable Recovery Systems

CUB has, in the past, argued that a reasonable approach to regulatory treatment for utility pensions would indeed be on a cash basis.[9] That proposal was made in a vacuum, however, and CUB recognizes today that switching to cash recovery, in the midst of another existing reasonable regulatory recovery approach (pension expense in this case), presents some significant complications when compared to starting from scratch. Notably, the transition, and even investigation into the transition, requires the expenditure of resources by all parties.[10] In light of this reality, CUB's discussion today will be framed with the assumption that if the Commission were to switch from the current FAS 87 expense based approach to a cash-based recovery approach, that it would do so with the intent to stick with the new cash-based approach for the foreseeable future. This is because both methods are reasonable recovery mechanisms over the long-term, the life of the pension. Shifting back and forth magnifies the transition issues.

CUB only believes that moving to a new method of recovery is beneficial if the system the Commission proposes to move to is a superior system and will be in place for an extended period of time. Moving between two equally adequate systems, while incurring transition costs, seems sub-optimal for all parties.

A review of some of the costs and benefits of each system, as demonstrated in CUB Figure 3, might be beneficial:

[9] UE 262/CUB/100/Jenks-McGovern/15.
[10] The transition to FAS 87 from cash, when implemented, created various logistical and financial hurdles for the individual utilities.

CUB Figure 3:

Pension Expense (FAS 87 & 88)	
Advantages	**Disadvantages**
Smooth	Creates timing issue
Current system	Depends on forecasts
Makes company whole	Complicated and formulaic
Linked to annual employee benefit	
Requires no company write off	

Cash-based	
Advantages	**Disadvantages**
Limits PPA to historical values only	Requires transition
Easily tractable	Requires prudency review
Makes company whole	Requires financing consideration
	Requires possible write off
	Lumpy

Notice that with a transition, many of the disadvantages of both systems must be internalized in order to appropriately decipher what recovery the utility is indeed entitled to, and in order for the utility to be made whole. However, when dealing with the transition, instead of becoming ongoing, complications are conglomerated into the transition period as transition costs. Therefore, moving to a cash-based system does not eliminate the need to deal with the complications of accrual accounting and the prepaid pension asset, it merely: (1) provides an upper bound by limiting the prepaid pension asset to historical and current values and (2) forces imminent decisions on methodology for dealing with accrual accounting and its complications. Therefore, CUB does not discount the value of continuing with the current system, as is. If the Commission were

to abolish the current system, and move to a cash-based recovery, the question of how to make the utilities whole in a manner that is fair to ratepayers would be central.

C. The Central Question

The utilities have brought to the Commission a request. That request is, on top of recovering in rates forecasted FAS 87 expense as a proxy for cash contributions, that the Commission allow the utilities to put in rates the return on the prepaid pension asset—a prepaid pension asset that has built up since the utilities switched from cash-based recovery to pension expense based recovery.[11] CUB does not believe that this is necessary or fair. However, the Commission has tasked the parties with making recommendations were utilities indeed required to make the switch to a cash-based recovery. Given this context, CUB believes that it is important to not restrict ourselves to the question of whether to pay the utilities the prepaid pension balance, but to instead answer the *central question*:

> *If required to transition from the current recovery mechanism to cash-based recovery, what is a fair and appropriate way to ensure that affected utilities are treated fairly and also to ensure that customers do not end up unfairly bearing costs?*

D. Option 1: Allow Recovery of ALL of the Prepaid Pension Asset.

i. Allowing Recovery <u>of</u> the Prepaid Pension Asset has the same problems as allowing a return <u>on</u> the Prepaid Pension Asset.

CUB objects to the idea that ratepayers should be required to pay for all historic decisions related to each utility's pension without regard to prudency or an examination of historic ratemaking treatment. CUB, Staff, and NWIGU-ICNU have spent considerable time discussing the inequity associated with awarding the utilities a return

[11] UM 1633/Joint Testimony/100/Joint Parties/10.

on the entirety of the prepaid pension asset in previous testimony. Similar reasons exist for caution regarding paying utilities a return ***of*** the entire prepaid pension asset. CUB's concerns about the prepaid asset, and the need to peel back the layers of that onion, are well documented on the record in this case.[12] While CUB's original arguments concerned the proposal to allow a return **on** the prepaid asset, they are just as valid when applied to allowing return **of** the prepaid asset. That being the case, we will not repeat those arguments here. Allowing return **of** the prepaid asset as a transition mechanism would be unfair to customers. To do so would allow recovery of costs that may be imprudent, and also recovery of costs that were never incurred or financed.

ii. The impact of allowing a return of the prepaid pension asset depends on the year chosen to value the asset.

The prepaid pension asset is, at any point in time (for example at end of year 2014), just a snapshot of the fluctuating variance between accounting systems -- accounting for pensions on an accrual basis and accounting for pensions on a cash basis. Because those two systems are intended to have a long-term functional relationship, evaluation at a single point, or date, does not accurately portray the historical, current and future relationship of those two systems. Because the prepaid pension asset fluctuates so much in monetary value, the date at which a decision is made to allow for return of the prepaid pension asset could make a significant difference to the total dollars involved. This phenomenon is demonstrated in UM 1633/Staff/200/Bahr/10, which shows that PGE's prepaid pension asset declined by more than $30 million in a single year, without any contributions being made by PGE to the pension plan. In order to get an idea of what

[12] *See* UM 1633/CUB/100/Jenks-McGovern and UM 1633 CUB/200/Jenks-McGovern.

the future will hold for FAS 87 and the prepaid pension asset, consider the example in CUB Figure 4, below. According to the theory that the sum of pension expense and cash contributions will both equal over time the FPC (in this example "37"):

CUB Figure 4:

Pension expense/ FAS 87	Cash contributions	Difference	PPA	Date
13	12	-1	-1	today -8
-20	3	23	22	today -7
3	0	-3	19	today -6
18	9	-9	10	today -5
-9	0	9	19	today -4
-2	0	2	21	today -3
8	0	-8	13	today -2
17	3	-14	-1	today – 1
-18	6	24	***23***	today
20	1	-19	4	today + 1
7	3	-4	0	today +2
Sum	Sum	sum	final	
37	37	0	0	end period

The highlighted cell is today's prepaid pension asset, in this hypothetical example. A few things are immediately clear:

(1) The prepaid pension asset of 23 has built up over the past 8 years, in various years taking two steps forward and one step back.

(2) If the utility has "under-collected" in the past several years under the FAS 87 approach, then it will over collect by exactly that amount in the coming years.

(3) The prepaid pension asset can grow in years where there are no contributions, and shrink in years where there were positive cash contributions.

(4) The beneficiary (utility or ratepayer) of the commission awarding a return of the PPA is entirely contingent upon the year in which the award is made.

iii. The transition mechanism should not include a return of the full prepaid pension asset.

The concerns that CUB has raised in this docket concerning allowing a return on the PPA apply to allowing a return of the PPA. However, allowing a one-time collection of the PPA as part of a transition to a cash-based system raises the additional concern associated with the timing of that decision. CUB would not support moving to a cash-based recovery mechanism for pension costs if doing so required a transition mechanism that included a return **of** the entire prepaid pension asset.

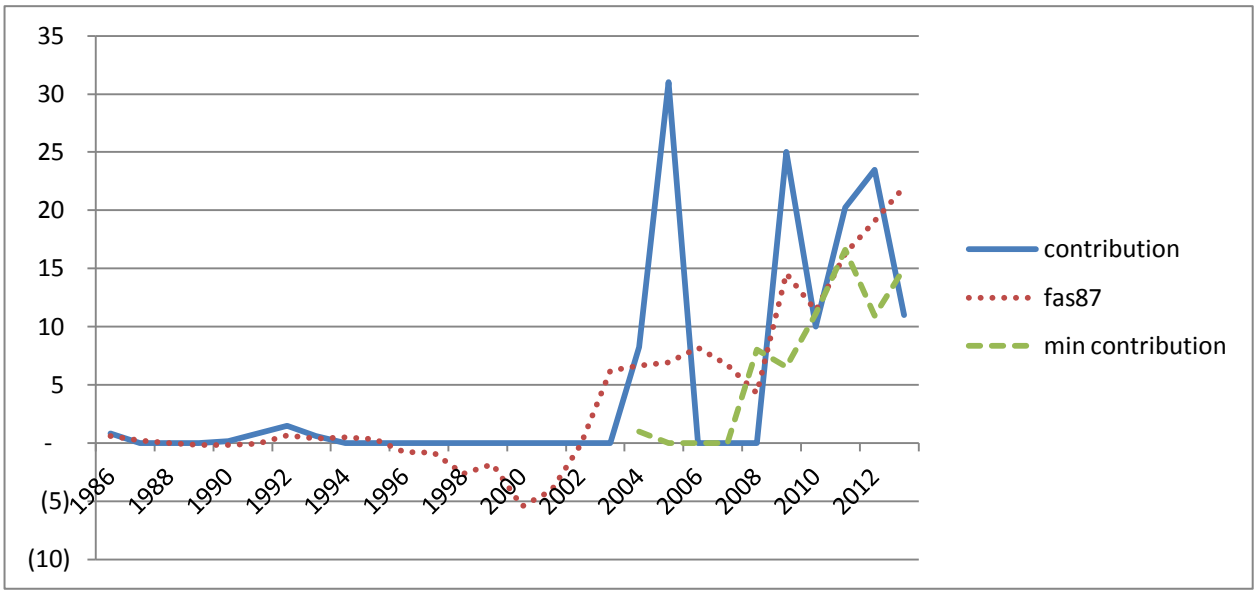
E. Option 2: Allow Recovery of SOME of the Prepaid Pension Asset.

As an alternative to allowing the return **of** the prepaid pension asset, the Commission could implement a transition mechanism that allows return **of *some*** of the prepaid pension asset. Utilities should not automatically earn a return of (1) **contributions above the minimum**, as they may not have been prudent. Utilities should not automatically receive a return of (2) **any monies they have not actually financed,** either through debt or shareholders. This includes negative FAS 87 expense. Utilities should not receive a return of (3) **contributions or net PPA accumulations before the Pension Protection act of 2006 or the financial collapse of 2008**, as the Utilities claim that these were the structural events which necessitated them seeking recovery on the prepaid pension asset.

i. Contributions above the minimum

For example, CUB Figure 5, a chart of NW Natural's (NWN) pension contributions, FAS 87 expense and minimum required contributions, shows that the Company often made contributions above the minimum:[13]

CUB Figure 5:[14]



Much of the discussion in this docket has focused on the Pension Protection Act required funding levels. But as we can see above, NWN has been making contributions well above what is required. In fact, because the minimum contribution level has been below the FAS 87 expense, if NWN had made the minimum contribution, it would have created negative FAS (contributions minus FAS 87 expense is negative) and the prepaid pension asset would have decreased. But NWN chose to contribute to the pension fund in amounts that are greater than FAS 87, thus increasing the prepaid pension asset. In this example, the prepaid pension asset is not growing due to pension funding requirements.

[13] NWN did not provide data for minimum contributions before 2004 (CUB DR 5).
[14] UM 1633/CUB/105/Jenks-McGovern.

On a forward-looking basis, it may be possible to establish a system to review pension contributions for prudence and to allow contributions above the minimum when the utility can prove that the contribution was prudent. However, on a historic basis, it will be nearly impossible to review all pension contributions to determine if they are prudent. Assuming that they are prudent up to the minimum level of contribution required would be a reasonable approach, would solve the prudence problem, and would be one way to allow recovery ***of some*** of the prepaid pension asset.

ii. Any monies they have not actually financed – Net Cash Methodology

An alternative to allowing collection of the PPA as a transition mechanism would be to focus, not on FAS 87, but instead on what has been collected in rates: compare the present value of cash contributions that the utility made from the point of its transition to the FAS 87 method of recovery up until the present and then to compare that dollar amount to the total amount of FAS 87 collected in rates. To return the entire PPA could result in over-compensation of the utilities, because as the record in this docket demonstrates, FAS 87 has not been accurately forecast in the past and because FAS 87 ratemaking has not been consistently applied. Because the utilities did not systematically collect or refund actual FAS 87 expense from/to customers to offset the inaccurate forecasts, netting out FAS 87 expense from the sum of cash contributions would be unfair as well as arbitrary.

A significant part of the inconsistent regulatory treatment of FAS 87 is the treatment of negative FAS 87. CUB has detailed the importance of this negative FAS 87 in previous testimony.[15] Because negative FAS 87 has not been systematically passed through to customers, allowing it be included in the prepaid pension asset, and allowing a

[15] UM 1633/CUB/100/Jenks-McGovern/10-19.

return of the prepaid pension asset, would require customers to reimburse utilities for monies that were never spent. Including negative FAS 87 in the amount awarded to utilities on top of contributions would unjustly inflate their recovery.

This problem is solved if regulatory treatment is not based on FAS 87, but instead based on the actual ratemaking treatment of FAS 87. CUB will refer to this as the Net Cash Method.

A method that begins with actual ratemaking treatment is relatively simple, mathematically speaking.

Net Cash=

$$PV\left(\sum_{transition\ date}^{transition\ date} prudent\ cash\ contributions\right) - PV\left(\sum_{transition\ date}^{transition\ date} \$\ collected\ in\ rates\right)$$

Notice the difference between this, and the prepaid pension asset.

PPA=

$$PV\left(\sum_{transition\ date}^{transition\ date} actual\ cash\ contributions\right) - PV\left(\sum_{transition\ date}^{transition\ date} actual\ FAS\ 87\right)$$

Upon comparison, one can immediately see that the Net Cash calculation differs from the PPA calculation because the amount actually collected in rates and FAS 87 expense is not always equal. Moreover, the Net Cash method proposes to reimburse the utilities only for prudent cash contributions, not all cash contributions. CUB believes that denying the utilities recovery of cash contributions that are imprudent is good ratemaking.

The more interesting difference between Net Cash and the Prepaid Pension Asset is the difference between the *"$ collected in rates*" and "*actual FAS 87*." Because the amount of monies collected in rates is (1) historical (2) at least somewhat verifiable and tractable and (3) a real transfer of funds from the ratepayers to the company, CUB believes that the Net Cash approach may be superior to awarding the utilities the prepaid pension asset, which nets out FAS 87 expense because FAS 87 expense (a) can be negative and (b) represents an accounting expense, not a real transfer of funds.

So that all seems quite simple, but, as we have found in the past in this docket, any attempt to look for simple solutions can turn out to have additional complications. In answer to our data requests on pensions, the dollar amount of pension contributions provided to us by the utilities was generally stated on a total company basis,[16] while the total dollars collected in rates from ratepayers represented an Oregon only allocation. This is important because, in the case of Avista, Idaho Power and even PacifiCorp, Oregon operations represent a minority share of the overall pension obligation. The net cash method would require that the historic pension contributions be allocated between Oregon, other states, and non-regulated activities both on a current and on an historical basis.[17] PGE is different because PGE is an Oregon-only utility, so there is no need to allocate contributions to other jurisdictions. Applying this methodology to PGE shows that the Net Cash method would reduce the amount that is left to recover from the prepaid asset of $[redacted] to $[redacted].[18] This makes logical sense. PGE's prepaid

[16] UM 1633, CUB/102, 104, 106/Jenks-McGovern.
[17] We note that this was not an issue when examining the prepaid pension asset, because the prepaid pension asset compares company-wide contributions to company-wide FAS 87 expense.
[18] UM 1633 CUB/107/Jenks-McGovern.

pension asset includes negative FAS 87 that was not passed through to customers,[19] while the Net Cash methodology does not include costs/benefits that were not passed through to customers.

CUB Figure 6:

Company	Total collected in rates Millions of $s	Total contributions Millions of $s	NET CASH
PGE	[redacted]	[redacted]	[redacted]

Some may argue that (1) introducing a new variable complicates the regulatory framework or (2) that the Net Cash approach is not equivalent to the PPA. CUB recognizes that this is a complicated process, and although adding more complexity is burdensome, this addition brings significant value. This process can also be modified to include the time value of money, because the period of contributions from both shareholders and ratepayers is identifiable. It is also true that Net Cash is not the same as the PPA. CUB believes that this may be a strength, and not a weakness, if the difference is improved accuracy.

CUB also recognizes that while this methodology is preferable in the case of PGE, there is not enough information to apply it to other utilities. To do so would require a methodology (both past and future) to allocate the pension contributions to Oregon.

[19] UM 1633/CUB/107/Jenks-McGovern.

And the question is, should this be done based on Oregon's share of load, or number of customers, or a combination of both factors? Should it be based on the year of the contribution, or should it recognize that the pension contribution is associated with a wide variety of years of pension obligations and adjust the allocation based on a wider time period? Consider PacifiCorp. Today, Oregon is about 23% of the load on PacifiCorp's system.[20] In a few years, Oregon may only be 20% of the system. A few years ago, Oregon was closer to 33% of the system. And this is just the regulated system because a few years ago, PacifiCorp had several significant unregulated affiliates:

> The Company is a diversified energy company in the United States and Australia. In the United States, the Company conducts a retail electric utility business through Pacific Power and Utah Power, and engages in power production and sales on a wholesale basis under the name PacifiCorp. The Company formed Holdings in 1984 to hold the stock of the Company's principal subsidiaries and to facilitate the conduct of businesses not regulated as domestic electric utilities. Holdings owns 100% of Powercor, the largest of the five electric distribution companies in Victoria, Australia, and a 19.9% interest in the 1,600 megawatt ("MW"), brown coal-fired thermal Hazelwood power station and adjacent brown coal mine in Victoria. The Company's strategic business plan is to strengthen the domestic and international scope and competitive position of its electric utility operations and to develop and expand its nonregulated, energy-related activities, including its energy marketing and trading businesses. The Company's goal is to become a dominant supplier of energy on a global basis.[21]

This causes CUB to ask if, when a utility makes a pension contribution, that year's allocation should be used for the calculation, or should the allocation be based on what Oregon's share of the system is expected to be over the entire life of the pension plan? If it is the latter, then how should that be determined?

[20] http://www.narucmeetings.org/Presentations/Parrish%20Fall%202013.pdf
[21] PacifiCorp 1997 10-K, http://www.getfilings.com/o0001047469-98-012019.html

iii. Comparing Contributions and net Prepaid Pension Asset accumulations before the advent of the Pension Protection act of 2006 or the financial collapse of 2008

CUB questions the validity of recovering in rates expenses that are decades old, the sum of which composes the prepaid pension asset. The Joint Utilities have claimed in earlier rounds of testimony[22] that the large impetus for requesting a return on the PPA was the financial collapse of 2008, combined with the Pension Protection Act of 2006. Besides these two events, the Joint Utilities have not identified significant events that justify additional recovery beyond the current mechanism. The Joint Utilities have not demonstrated how the events preceding 2006 (or even the financial crisis of 2008) were so out of the ordinary that they were unfairly disadvantaged. CUB believes that recovery **on,** or **of,** the prepaid pension asset is tantamount to retroactive ratemaking, and while it is sympathetic to the fact that the recession combined with the Pension Protection Act required utilities to make cash contributions, CUB believes that this was a risk that was inherent to companies with pensions. However, to the degree that the transition to a cash-based recovery methodology requires allowing some of the PPA to be recovered, CUB believes such recovery should be limited to the time period after the Pension Protection Act of 2006 was passed. Figure 7, below, compares a prepaid asset transition based on the 2013 prepaid asset amount (recognizing that the year picked has a large impact) with the prepaid pension asset that exists if you count only the years 2006-2013.

[22] UM 1633/Joint Testimony/200/Vogl/7-12.

CUB Figure 7:

Company	Prepaid pension asset transition - 2013	Prepaid pension asset 2006-2013
Avista[23]	[redacted]	[redacted]
Cascade[24]	17.7	N/A
Idaho[25]	[redacted]	[redacted]
NWN[26]	25.2	-11.8
PacifiCorp[27]	310.9	328.1
PGE[28]	[redacted]	[redacted]

In the case of [redacted].

F. Option 3: Allow Recovery of NONE of the Prepaid Pension Asset.

CUB believes that the proposal to require the utilities to write off the entire prepaid pension asset, in the case of a transition to a cash-based recovery, has some merit and deserves discussion. CUB does, however, recognize that this proposal will receive heavy pushback from the utilities. But requiring a utility to write off the entire prepaid pension asset, in the case of transitioning to cash, is justified on several fronts.

i. This docket was borne of opportunism.

It is CUB's position that since timing matters, the utilities should not get to choose the timing, and thereby the value, of the prepaid pension asset. The current

[23] UM 1633/CUB/102/Jenks-McGovern.
[24] UM 1633/CUB/103/Jenks-McGovern.
[25] UM 1633/CUB/104/Jenks-McGovern.
[26] UM 1633/CUB/105/Jenks-McGovern.
[27] UM 1633/CUB/106/Jenks-McGovern.
[28] UM 1633/CUB/107/Jenks-McGovern.

pension regulatory system has been in place for years. For much of the life of FAS 87 ratemaking in Oregon, utilities were recovering in rates FAS 87 costs that were in excess of their pension contributions (usually 0).[29] This served the interests of the utilities. In many cases, utilities had accrued pension liability (the inverse of the prepaid pension asset) and would have had to pay customers a return on that accrued liability under the ratemaking theories the utilities currently advance. The recent recession created the need to make significant pension contributions, causing the utilities to have to make pension contributions, which were not immediately recoverable under FAS 87 ratemaking. Utilities want to change the ratemaking methodology available to them because now is a good time for it - from their perspective. From customers' perspective, this is the worst time for the Commission to permit a change to the current methodology.

ii. Companies write off expenses frequently.

Because this is a one-time only transition, this would not be an ongoing expense to write off. The write-off would only apply to amounts that would have been subject to Oregon recovery under FAS 87, not amounts subject to pension recovery in other states. A write-off of a singular event is not that unusual. PacifiCorp was required to write off a large sum when it chose to switch to FAS 87 recovery when the Commission last changed the pension accounting methodology.[30] Over the years, PGE has had to make several significant write-offs associated with Boardman[31] and Trojan.[32] In explaining this write-off to investors, the utilities would be able to explain that although there was a one-time write off associated with a change in Commission practice, that change in regulatory

[29] *See* UM 1633/CUB/102-107/Jenks-McGovern.
[30] UM 1633 CUB/301/Jenks-McGovern.
[31] http://files.shareholder.com/downloads/POR/0x0x352791/c70d8e8a-7477-4e86-8ee7-d4d3a878bba6/POR_News_2010_2_25_Financial.pdf
[32] http://investors.portlandgeneral.com/releasedetail.cfm?ReleaseID=337803

practice ensures the utility dollar-for-dollar recovery of all pension contributions going forward. The utility would also be able to detail the period over which the contributions would be recovered, and the rate of return. While there is little doubt that investors and ratings firms are not proponents of write-offs, a one-time only event can be explained and, in this case, is at least partially offset by the decrease in risk associated with recovery of pension contributions.

iii. The utilities would not absorb the full amount of the write-off as the loss would trigger a tax benefit.

There would, of course, be tax benefits associated with the write-off. Instead of ratepayers bearing the full cost of the PPA, in this case, the utility would absorb a portion and taxpayers (a larger base than ratepayers) would absorb the rest, as a decrease in tax revenue.

iv. Finally, it is the utilities that have autonomy and must accept the risk for their decisions.

Each of the utilities chose to offer their employees a pension plan. Each pension plan is a contract between the utility and its employees. It is the utility, not its customers, that made the commitment and agreed to take the risk that is associated with a pension plan, including the risk that ratemaking treatment can change over time. It is the utilities that chose to move to FAS 87 recovery years ago when such a change allowed them to add charges to customers' bills, and now, when FAS 87 is no longer favorable to them and has proven to be too slow for their liking, the utilities would like to enhance their options by adding the return on the PPA to their other recoveries.

The utility generally bears the risk that regulatory treatment can change. If the Commission believes that a contribution based mechanism for ratemaking would be the better methodology, then it is not unreasonable for the Commission to simply adopt it, recognizing that this is a risk that the utilities have accepted.

IV. After a Transition: A Mechanism for Recovery Based on Cash Contributions

If the Commission decides to move to cash recovery, then two mechanisms need to be established. First there needs to be one mechanism to reimburse the Companies each time a contribution is made - an ongoing mechanism. Second, in addition, once the Commission has decided upon the amount of money that will be allocated to the utility and the ratepayers in settling the transition, then the question of a one-time financing mechanism must be addressed.

A. Ongoing Mechanism

i. Assumptions for Going Forward

Under a cash structure, presumably the utilities would:

(1) make cash contributions to the pension plan.
(2) subject those contributions to a prudence review
(3) allocate those contributions to regulated operations in Oregon, and
(4) recover the prudently deemed contributions from ratepayers over a designated term, through rates with interest.

In other words, making a cash contribution would be an action taken by a utility that would trigger a mechanism, and the mechanism would have to subject those contributions to a prudence review, allocate those contributions to regulated operations in Oregon, and allow recovery over time.

ii. Mechanism Proposals and Options

The first issue in this section concerns the conduct of a prudence review. A simple solution might be to say that contributions up to the minimum are considered prudent, but any contribution above the minimum is not. In this testimony, CUB has argued that this is reasonable when applied to the transition mechanism's historic contributions, where determining prudence at the time of the contribution will be difficult. On a going-forward basis, because the prudence review would happen near the time of the contribution, it may make sense to allow some contributions above the minimum if the utility can demonstrate the prudence of those contributions. It may make sense to treat this similar to hedges. A utility must have a policy that guides how it applies pension contributions. If the policy is deemed prudent, then the utility must show that it is acting consistently with its policy.

The second issue concerns allocation to regulated operations in Oregon. This is a bit complicated because over the life of the period, Oregon's share of a utility may change significantly. In fact, in many cases the utility may be owned by a different parent company with different affiliates than it had been when its pension plan began. How to adjust for other states' shares of the pension liability and how to adjust for non-regulated operations is an issue that will have to be resolved. It will be necessary to determine a relationship between the pension contribution and the timeframe of the pension liability associated with that contribution. Determining Oregon's share of a pension contribution will be different depending on whether Oregon's share relates to the current year's pension liability or to the liability associated with the pension over the entire life of the pension plan.

The third issue relates to the time period for recovery and to the interest rate. There are many methodologies that could capture the time value of money to the ratepayers and utilities, if an amount of the prepaid pension asset or accrued pension liability were deemed appropriate to pay to the utilities or the ratepayers. CUB looks at some of these methodologies for spreading out the burden of cash flow. CUB sees two main considerations in determining the mechanism (1) the timing, and (2) the interest rate.

For the timing, if a utility makes a cash contribution, the Commission needs to pick a time period for recovery. There could be a default period of time (5 years or 10 years) that is used unless the Commission decides upon a different approach.

For the rate of return, the Commission could use the authorized cost of capital or it could use the blended treasury rate plus 100 basis points. Often times, the difference between the two is whether there is risk in recovery. Here, once a prudence determination is made, the costs are authorized for recovery, but it is not clear whether recovery is being made in a manner similar to rate base or in a manner similar to deferred accounting. For rate base, there is a level of depreciation each year and we forecast recovery to match up with that depreciation. But because of variations in loads and in weather, there is a risk of over or under-recovery. With a deferred account, we authorize recovery of a particular dollar amount. Variations in loads and risks affect the speed at which recovery happens but do not impact the level of recovery. In this case, the interest rate used might be determined by which recovery method is used for the balancing account.

B. One Time Mechanism

The one-time mechanism differs in substance and function substantially from the ongoing mechanism. Aside from the one-time nature, the mechanism dealing with the transition dollars is meant to deal with an accumulation of funds and expenses over several years, maybe decades, whereas the ongoing mechanism is merely meant to spread out one year's worth of contributions in rates. In addition, if the Joint Utilities are granted their full request, and get dollar for dollar recovery of the prepaid pension asset, then CUB might argue that ratepayers deserve considerate treatment when the Commission is determining financing terms. CUB believes that because the transition asset is an asset that will last the length of the pension, financing that asset over a similar length of time is reasonable. In addition, if the guarantee of payment is risk free, then the recipient should earn a risk free rate of return.

V. Conclusion

The current approach to pension recovery, FAS 87 expense, works. Over the life of the pension, FAS 87 will allow the utility to fully recover the pension costs. An alternative approach based on contributions to the pensions will also allow the utility to fully recover its pension costs. If CUB could choose one method over the other, CUB would choose the contribution method.

But the question here is not which methodology is preferable. The question here is whether the benefits of moving to a system based on contributions (CUB's preferred method) is worth the transition cost of changing systems. Because each method fully recovers the utility's costs, either method is a reasonable approach. But the timing has a

huge impact on the cost of the transition and the transition costs have a large effect on whether such a change is beneficial.

CUB is supportive of shifting to a contribution-based system if no recovery of the prepaid pension asset is allowed. CUB believes this is a fair and reasonable approach that will lead to fair, just and reasonable rates. While this approach would create a write-off, that write-off would be a one-time only event that would allow Oregon to move to a system where the utility could expect to recover all prudently incurred contributions.

As previously stated, CUB recognizes that the utilities will argue that CUB's proposed transition methodology is not fair and will, therefore, push to allow recovery of the entire prepaid pension asset. If the Commission were to grant the Joint Utilities request, CUB would oppose any such transition.

The other alternative discussed by CUB was a methodology that allows utilities to recover ***some*** of the PPA. CUB believes that it is possible to design a mechanism that would exclude such things as contributions above the minimum, costs that were never incurred, and contributions made before 2006. With those parameters in place CUB believes that it ***might*** be possible to develop a mechanism that would be fair to both customers and the utility and would result in rates that are fair, just and reasonable for all. But the details clearly matter.

UM 1633/PacifiCorp
December 6, 2013
CUB Data Request 30

CUB Data Request 30

According to the Company's response to CUB DR5, for the years 1998-2005, the Company showed a negative prepaid pension asset, also known as an accrued pension liability. Please specify the years and the amounts in which the company paid customers a return on the accrued pension liability, if any.

Response to CUB Data Request 30

The accrued pension liability was not included in rate base and accordingly, no return was paid to customers on the accrued pension liability.

UM 1633 – CERTIFICATE OF SERVICE

I hereby certify that, on this 25th day of September, 2014, I served the foregoing **OPENING TESTIMONY OF THE CITIZENS' UTILITY BOARD OF OREGON** in docket UM 1633 upon each party listed in the UM 1633 PUC Service List by email and, where paper service is not waived, by U.S. mail, postage prepaid, and upon the Commission by email and by sending one original five copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

(W denotes waiver of paper service)

(C denotes service of Confidential material authorized)

W **AVISTA CORPORATION**
C DAVID J MEYER
PO BOX 3727
SPOKANE WA 99220-3727
david.meyer@avistacorp.com

W **AVISTA UTILITIES**
C ELIZABETH ANDREWS
PO BOX 3727
SPOKANE WA 99220-3727
liz.andrews@avistacorp.com

W **AVISTA UTILITIES**
C PATRICK EHRBAR
PO BOX 3727
SPOKANE WA 99220-3727
pat.ehrbar@avistacorp.com

W **CABLE HUSTON BENEDICT**
C **HAAGENSEN & LLOYD**
TOMMY A BROOKS
1001 SW FIFTH AVE, STE 2000
PORTLAND OR 97204-1136
tbrooks@cablehuston.com

W **CABLE HUSTON BENEDICT**
C **HAAGENSEN & LLOYD LLP**
CHAD M STOKES
1001 SW 5TH - STE 2000
PORTLAND OR 97204-1136
cstokes@cablehuston.com

W **CASCADE NATURAL GAS**
C PAMELA ARCHER
8113 W GRANDRIDGE BLVD
KENNEWICK WA 99336
pamela.archer@cngc.com

W **CASCADE NATURAL GAS**
C MICHAEL PARVINEN
8113 W GRANDRIDGE BLVD
KENNEWICK WA 99336
michael.parvinen@cngc.com

W **CASCADE NATURAL GAS**
C MARYALICE ROSALES
8113 W GRANDRIDGE BLVD
KENNEWICK WA 99336
maryalice.rosales@cngc.com

W **DAVISON VAN CLEVE PC**
C S BRADLEY VAN CLEVE
333 SW TAYLOR - STE 400
PORTLAND OR 97204
bvc@dvclaw.com

W **DAVISON VAN CLEVE PC**
C TYLER C PEPPLE
333 SW TAYLOR - STE 400
PORTLAND OR 97204
tcp@dvclaw.com

W **IDAHO POWER COMPANY**
C LISA D NORDSTROM
PO BOX 70
BOISE ID 83707-0070
lnordstrom@idahopower.com

W **IDAHO POWER COMPANY**
REGULATORY DOCKETS
PO BOX 70
BOISE ID 83707-0070
dockets@idahopower.com

W **LARKIN & ASSOCIATES PLLC**
C RALPH SMITH
15728 FARMINGTON RD
LIVONIA MI 48154
rsmithla@aol.com

W **MCDOWELL RACKNER & GIBSON**
C LISA F RACKNER
419 SW 11TH AVE., SUITE 400
PORTLAND OR 97205
dockets@mcd-law.com

W **NWIGU**
C EDWARD FINKLEA
326 FIFTH ST
LAKE OSWEGO OR 97034
efinklea@nwigu.org

W **NORTHWEST NATURAL**
C MARK R THOMPSON
220 NW 2ND AVE
PORTLAND OR 97209
mark.thompson@nwnatural.com

W **NORTHWEST NATURAL**
E-FILING
220 NW 2ND AVE
PORTLAND OR 97209
efiling@nwnatural.com

W **PACIFIC POWER**
C R BRYCE DALLEY
825 NE MULTNOMAH ST., STE 2000
PORTLAND OR 97232
bryce.dalley@pacificorp.com

W **PACIFIC POWER**
OREGON DOCKETS
825 NE MULTNOMAH ST, STE 2000
PORTLAND OR 97232
oregondockets@pacificorp.com

W **PACIFIC POWER**
C SARAH WALLACE
825 NE MULTNOMAH ST STE 1800
PORTLAND OR 97232
sarah.wallace@pacificorp.com

W **PORTLAND GENERAL ELECTRIC**
C JAY TINKER
121 SW SALMON ST 1WTC-0702
PORTLAND OR 97204
pge.opuc.filings@pgn.com

W **PORTLAND GENERAL ELECTRIC**
C DOUGLAS C TINGEY
121 SW SALMON 1WTC1301
PORTLAND OR 97204
doug.tingey@pgn.com

W **PUC STAFF - OREGON DOJ**
C JASON W JONES
1162 COURT ST NE
SALEM OR 97301-4096
jason.w.jones@state.or.us

W **PUC OF OREGON**
C BRIAN BAHR
PO BOX 2148
SALEM OR 97308-2148
brian.bahr@state.or.us

//

//

//

Respectfully submitted,

Sommer Templet, OSB #105260
Staff Attorney
Citizens' Utility Board of Oregon
610 SW Broadway, Ste. 400
Portland, OR 97205
(503) 227-1984 phone
(503) 224-2596 fax
sommer@oregoncub.org