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September 25, 2014

VIA ELECTRONIC FILING AND FIRST CLASS MAIL

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

Re: Docket UM 1633

Attention Filing Center:

On behalf of Portland General Electric, PacifiCorp, Avista Utilities, Cascade Natural Gas, and NW Natural Gas ("Joint Utilities), enclosed in the above-referenced docket are an original and five copies of Joint Utilities Opening Testimony. 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

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BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UM 1633

Joint Opening Testimony of

Portland General Electric,
PacifiCorp,
Avista Utilities,
Cascade Natural Gas,
NW Natural Gas
("Joint Utilities")

EXHIBIT 500

September 25, 2014

I. INTRODUCTION AND SUMMARY

Q. Please state your names.

A. Our names are Doug Stuver, Brody Wilson, Patrick Hager, Ryan Krasselt, and Michael Parvinen.

Q. Are you the same witnesses who filed direct testimony in this case?

A. Yes. We have previously filed Joint Direct Testimony (Joint Testimony/100) and Joint Reply Testimony (Joint Testimony/300).

Q. What is the purpose of this testimony?

A. This testimony responds to the Commission's request for additional information related to how pension costs should be recovered in rates. This generic investigatory docket was opened to consider whether, as a matter of policy, it is appropriate for a utility to recover the financing costs associated with the prepaid pension asset (*i.e.,* the cumulative cash contributions in excess of cumulative pension expense) as a component of overall pension cost recovery.[1] The Commission currently uses each utility's FAS 87 expense to determine the amount of pension costs to include in rates. However, changes in federal law, together with the effects of the 2008 recession, have required the Joint Utilities to make significant cash contributions to their pension plans before pension costs are expensed under FAS 87. This leads to a timing difference between actual cash outlays required of the utility and rate recovery of pension expense. This timing difference is represented by substantial prepaid pension assets for each of

[1] *Re NW Natural Request for a General Rate Revision*, UG 221, Order No. 12-408 at 4,12 (Oct. 26, 2012) ("We will open a docket to review the treatment of pension expense on a general, non-utility-specific, basis.")

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the Joint Utilities. To date the Joint Utilities have absorbed the costs of financing these prepaid pension assets. However, in response to the increasing financing costs, the Joint Utilities requested a change in Commission policy that would allow them to recover future financing costs. Accordingly, the Joint Utilities asked the Commission to find that, on a going-forward basis, it is appropriate to add the existing prepaid pension asset[2] (which represents the total pension costs being financed by the utilities) to rate base, and thereby allow the utilities to recover their future financing costs through rates.

Following several rounds of testimony, the Commission suspended the procedural schedule in this docket to seek additional information. Specifically, the Commission sought additional testimony related to the continued use of FAS 87, as opposed to switching to use of cash contributions, as the basis for setting rates. The Commission recognized that the parties unanimously supported the continued use of FAS 87, but felt that the alternative of using cash contributions as a basis for rate recovery was not adequately addressed in the record.

The Commission convened a workshop on July 10, 2014, and thereafter Chief Administrative Law Judge Grant issued a Prehearing Conference Memorandum that posed the following question to be addressed in two additional rounds of testimony:

> 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

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[2] The Joint Utilities recognize that timing differences between FAS 87 expense and contributions can result in an accrued pension liability when cumulative FAS 87 exceeds cumulative contributions. However, because all of the Joint Utilities have prepaid pension assets, for simplicity and clarity this testimony will focus on pension assets as opposed to liabilities.

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assets, the transition period, the mechanism to recover the cash contributions, and the mechanism to implement the transition?

Our testimony first addresses the Commission's specific questions pertaining to a transition to cash contributions as the basis for pension cost recovery. Specifically, we discuss the advantages and disadvantages of cash-based recovery, including how a transition to cash-based recovery would require a plan to recover the Joint Utilities' existing prepaid pension assets. We also provide a specific framework to normalize cash contributions for ratemaking purposes, in light of the fluctuations and unpredictability in the level of cash contributions from year to year.

In addition, we respond to specific arguments made by the parties at the July 10th workshop.

Q. Please summarize your testimony.

A. The Joint Utilities continue to request that the Commission allow recovery of their pension-related costs through the recovery of FAS 87 expense, as well as their costs to finance the prepaid pension asset created by the timing differences between when cash is contributed to pension plans and when that cash contribution is recovered in rates. FAS 87 is a time-tested methodology for the recovery of pension expense that has worked well historically and, with the additional recovery of financing costs, provides reasonable pension cost recovery. To date, no party has provided a persuasive reason to fundamentally change how pension costs are recovered; nor has any party disputed the existence of financing costs associated with the prepaid pension asset.

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If the Commission were inclined to move to cash-based pension cost recovery, such a change could be feasible, provided the transition allows for full cost recovery of each company's existing prepaid pension asset. Under the current FAS 87-based recovery, each company's existing prepaid pension asset will ultimately be recovered through future FAS 87 expense. If FAS 87 is no longer used to set rates, then there must be a regulatory mechanism that would allow recovery of the cash contributions made in excess of the cumulative FAS 87 expense recorded at the date of transition. The Joint Utilities recommend that the prepaid pension asset be amortized and recovered over five years to smooth the impact to customers, with the unrecovered balance accruing interest at each company's authorized cost of capital.

If cash contributions are used to set rates, the Joint Utilities recommend that the Commission use either a three- or five-year average of forecast contributions to set rates. Using an average will smooth the year-to-year volatility of cash contributions. The Joint Utilities also recommend that any difference between each company's actual cash contributions and the amount included in rates be included in a balancing account for later recovery or refund and be subject to a carrying charge equal to each utility's cost of capital.

Regardless of whether pension cost recovery is based on cash contributions or FAS 87 expense, the historical cash contributions, FAS 87 expense, and the resulting prepaid pension asset (which is the difference between the two) need not be subject to additional prudence reviews in the future. Because pension costs have consistently been included in rates using FAS 87 expense, and because FAS 87 expense is based, in part, on cash

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contributions, the prudence of those contributions has already been subject to review in past rate-setting proceedings. At any rate, if the Commission concludes that a prudence review is required, it should perform that review in utility-specific proceedings, not in this general policy docket. If the Commission were to go down that path, we believe the review for prudence should be focused on ensuring that we have made prudent cash contributions to the plan and have recognized our FAS 87 expense in accordance with GAAP.

Last, this testimony addresses certain misconceptions raised by Staff and intervenors in prior testimony and reiterated at the July 10th workshop. Specifically, we make clear that the prepaid pension asset cannot grow indefinitely and, in fact, is directly reduced, or "amortized," through FAS 87 expense. We also correct a mischaracterization of the role of FAS 88 in pension costs.

II. DISCUSSION

A. Pension Cost Overview

Q. What are cash contributions to a pension plan?

A. A pension plan is an employer-sponsored retirement plan that provides pre-defined payments to eligible employees once they retire.[3] To ensure that the pension plan has sufficient funds to pay each retired employee, the Joint Utilities, like all employers providing pension plans, are required to make cash contributions to fund their plans. These cash contributions are direct cash payments made to the pension plan which, like all other company investments,

[3] Joint Testimony/100, Joint Parties/4-5.

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are financed by the company through a mix of debt and equity. In other words, the Joint Utilities finance their cash contributions at the same cost of capital as that incurred to finance all other investments made to serve customers. Cash contributions improve a pension plan's funded status. They also reduce future FAS 87 expense and reduce future cash contributions.

Q. Please describe exactly what you mean when you describe "financing costs," "carrying costs," or the "cost of capital" associated with pensions.

A. We use these terms to describe the costs incurred by the utility when it is required to come up with cash to make payments (i.e. contributions) that it has not recovered through rates, and which it may not recover for some time. The Joint Utilities need to finance these cash payments in the same way as they finance cash payments for nearly all major assets that they purchase on behalf of customers, including utility plant additions. And like the financing of those other assets, the Joint Utilities use a mixture of equity (put up by shareholders) and debt (in the form of bonds) to accomplish the financing. The Commission determines the cost of that financing for each of us when it determines our cost of capital through determining our debt cost and the shareholder required return on equity (ROE) in general rate cases.

Q. Can you provide a general overview of how the Joint Utilities determine their cash contributions to pension plans?

A. Yes. Pension funding is governed by laws described in the Internal Revenue Code (IRC), which determine the annual minimum required contribution and the annual maximum tax-deductible contribution. In other words, the IRC establishes the minimum and the maximum tax deductible cash contributions each company

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can make in a particular year. Actual funding decisions for a particular company can include other factors, such as maintaining minimum funding status to avoid certain restrictions; accordingly, a company might choose to fund an amount higher than the minimum required cash contribution. However, as a practical matter, the utilities are unable to think of a circumstance where an employer would choose to make a contribution higher than the tax-deductible maximum.

Q. What is FAS 87 expense?

A. Statement of Financial Accounting Standards ("FAS") No. 87 as codified under ASC 715 is the accounting standard that determines each company's pension "expense."

Generally, "expenses" are costs incurred that flow through to each company's earnings under accounting rules. When a utility makes a cash contribution to its pension plan in a particular year, the entirety of that cash contribution is not "expensed," *i.e.*, the entire cash contribution is not subtracted from revenues for purposes of determining a utility's earnings in the year the contribution is made. Rather, only the amount calculated pursuant to FAS 87 is expensed. The remaining difference between the cash contribution and the FAS 87 expense is accounted for as either an accrued liability (when FAS 87 expense exceeds contributions) or as a prepaid pension asset (when contributions exceed FAS 87 expense).[4] 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. Or, conversely, the accrued liability represents the amount of FAS 87 expense in excess of each company's contributions. Because rates are currently

[4] The total prepaid pension asset is the cumulative difference between the cash contributions and the FAS 87 expense.

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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.

Q. Can you provide an example of the difference between expenses and assets in ratemaking?

A. Yes. When a utility builds a transmission line, the only portion of that line that is collected as an "expense" in rates is the depreciation for that year. The remainder of the costs are accounted for as an "asset" and expensed only in the future by each year's depreciation. FAS 87 expense can, to some extent, be analogized to the depreciation expense, whereas the prepaid pension asset can be analogized to the remaining costs of the transmission line that have not yet been expensed.

B. <u>Cash-Based Recovery</u>

Q. If the Commission were inclined to transition from FAS 87-based recovery to cash-based recovery, how would such a transition work?

A. A transition from FAS 87-based recovery to cash-based recovery would need two distinct components. First, the Commission would need to adopt a plan for the recovery of each of the Joint Utilities' existing prepaid pension asset. Second, the Commission would need to adopt a mechanism for recovery of the Joint Utilities' future cash contributions.

Q. Why does the Commission need to adopt a plan for utilities to recover their existing prepaid pension assets?

A. A transition plan is necessary to ensure that the Joint Utilities are able to recover their full pension costs and to ensure that a change to cash-based recovery does

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not result in immediate and permanent disallowances of future FAS 87 expense that would lead to a significant write-off.

Q. How might a change to cash-based recovery result in an immediate and permanent disallowance?

A. If the transition does not allow full recovery of each utility's existing prepaid pension asset, the utilities will suffer a permanent disallowance of costs that would otherwise have been recovered through FAS 87 expense.

As we have previously explained, the utilities record pension expense on their books in accordance with FAS 87, which requires employers to recognize the cost of their pension plan on an accrual (as opposed to a cash) basis.[5] On the other hand, the Joint Utilities actually *fund* their pension plans with cash contributions in accordance with the requirements of federal law. The cash contributions and the FAS 87 expense recorded on the utilities' books in a given period are not equal and are not intended to be equal. Over the life of the pension plan, however, the cumulative pension expense will equal the cash contributions. Therefore, the primary difference between the pension expense and the cash costs is one of timing. The prepaid pension asset (or accrued pension liability) represents the timing difference between cash contributions paid by each Joint Utility to the pension plan and expense incurred. If rates continue to be based on FAS 87 expense, then all of the Joint Utilities' cash contributions made to date will ultimately end up in FAS 87 expense and be fully recovered over time.

[5] Joint Testimony/100, Joint Parties/7-8; Joint Testimony/200, Vogl/4.

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However, if rates are based on cash contributions, rather than FAS 87 expense, then the cash contributions in excess of FAS 87 expense that were made before the transition will not be recovered because future rates would be based on future cash contributions. This means that cash contributions that would have been recoverable under the current FAS 87-based recovery, would become unrecoverable —and for no legitimate reason. Thus, without a plan for recovery of the prepaid pension asset, a switch to cash-based recovery would mean that the utilities would be forced to write-off, at a minimum, the full amounts of their prepaid pension assets. A continuation of the current FAS 87 expense-only recovery framework would be preferable to this unfair outcome.

Q. Are there any analogies that may be helpful in demonstrating the need for a transition if the Commission were to change to cash-based recovery?

A. Yes. To use the simple transmission line example discussed above, if the Commission were to switch from a method of allowing utilities to recover their depreciation expense on a transmission line that had already been built to a method of allowing utilities to recover the future cash contributions they make toward the line, there would obviously need to be a transition to allow for some method of recovering the cash that was initially put up to build the line, but which had not yet been expensed. Otherwise, a major portion of the utility's investment in the asset for customers would never be able to be recovered.

Q. Can you provide an example demonstrating how the prepaid pension asset can become an unrecoverable stranded investment if the Commission switched to cash-based recovery?

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A. Yes. This is easily shown through a simple example, where a utility makes $10 million in pension contributions cumulatively over five years and recognizes $6 million in FAS 87 expense over those same five years. Under existing FAS 87-based recovery, the utility would have recovered $6 million from customers and would have a prepaid pension asset of $4 million at the end of the 5 years. If the utility were required to switch to cash-based recovery going forward with no consideration for the past, they would have no mechanism to recover the stranded $4 million that, under FAS 87 expense-based recovery would have been recovered over the life of the plan.

Q. What is your proposal for the transition plan?

A. We propose that each Joint Utilities' prepaid pension asset or accrued pension liability as of the date of the transition, be amortized and recovered over a five-year period. Recovery of the prepaid pension asset over five years is reasonable to mitigate the immediate impact on customers that would occur if the transition were accounted for all at once, or in one single year.

Q. Would the unrecovered balance earn interest?

A. Yes. During the amortization period, the unrecovered balance should earn interest equal to each company's authorized cost of capital. As we described above, the Joint Utilities have financed their cash contributions, and thus their prepaid pension assets, using the same blend of debt and equity that is used to finance all other utility investments. Therefore, it is reasonable for the unrecovered balance to earn the same rate of return as all other utility investments until the balance is fully recovered after five years. To the extent the amortization and recovery period is significantly extended, cumulative financing

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costs would increase and could potentially reach the level that would have occurred had the prepaid pension asset simply been included in rate base and FAS 87-based recovery continued.

Q. Are there utility-specific issues that will need to be addressed during the transition period?

A. Yes. NW Natural currently has a balancing account that is used to track differences between the pension expense included in rates and the Company's actual FAS 87 expense. As discussed in NW Natural's testimony, the outstanding amounts contained in this account will need to be addressed if the Commission chooses to transition to cash-based recovery.

Q. If the Commission were to switch to cash-based recovery, how should future cash contributions be included in rates?

A. In a general rate case, cash contributions should be included in rates based on either a three- or five-year average of forecasted cash contributions. Because cash contributions are volatile (*i.e.*, they are large in some years, and small or zero in other years), using a three- or five-year average will result in a more normalized result.

In addition, we would propose that the difference between each company's actual contributions and the amounts included in rates, whether positive or negative, would be included in a balancing account. This balancing account would accrue interest at the company's authorized cost of capital, for the reasons described above, and is common practice. When the pension cost is reset—presumably in each company's rate case-- the amount in the balancing

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account would be accounted for as an adjustment, whether positive or negative, to the new average three- or five-year forecasted level contributions.

Q. Are there any additional issues that would need to be addressed as part of a transition to cash-based recovery?

A. Yes. Because the utilities will be required to continue to account for their pension plans under FAS 87 (ASC 715) and recognize expense according to this accounting standard, it would be critically important that the Commission order adopting cash-based recovery provide the utilities with explicit assurance that they will be allowed the opportunity to recover the existing prepaid pension asset balance and all future contributions and that they may apply FAS 71 (ASC 980) accounting for differences between the recovery on a cash basis and the expense recognition based on FAS 87. This would be necessary to avoid illogical impacts on company earnings that could otherwise result if the requirement for FAS 87 accounting and the Commission's recovery approach were not reconciled.

Q. What are the advantages of using cash-based recovery?

A. A recovery framework based on cash contributions is probably easier to understand than one based on FAS 87. Cash contributions are conceptually more straightforward because they are simply cash outlays, whereas complex calculations are required to determine a company's FAS 87 expense. Moreover, as discussed above, a transition to cash-based recovery will require the amortization of the prepaid pension asset; as a result, a cash-based approach will minimize the financing costs and the resulting impact on customer rates. That said, the mechanism required to facilitate the transition to cash contributions,

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(*i.e.*, the use of forecasted contributions and the resulting balancing account discussed above) along with recovery of the existing prepaid pension asset with a carrying charge during the recovery period, may be as complicated as continuing to use FAS 87 and allowing the Joint Utilities to recover their financing costs associated with the prepaid pension asset.

Q. What are the disadvantages of switching to cash-based recovery?

A. First, cash contributions are generally volatile, requiring large contributions in certain years and small or no contributions in others. While using a three- or five-year forecast average would reduce this volatility, a recovery framework based on cash contributions would likely result in greater volatility than one based on FAS 87. Adding further volatility is the fact that the legal requirements that dictate the methodology for computing the minimum funding requirements have been subject to more frequent changes, as compared to the FAS 87 methodology, which has been consistent for nearly thirty years. In short, FAS 87 is consistent and specifically designed to smooth out pension expenses. It is, therefore, in many ways a good fit for ratemaking, which often prioritizes these goals.

Using cash contributions could also prove problematic for multi-jurisdictional utilities where other jurisdictions continue to use FAS 87.

Q. How did Idaho Power make the transition to cash-based recovery?

A. When Idaho Power sought clarification with the Idaho Public Utilities Commission ("IPUC") that it was authorized to recover pension costs on a cash basis, their prepaid pension asset was nearing $0 and crossed over to an accrued pension liability shortly thereafter. Therefore, unlike the Joint Utilities in this docket,

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neither Idaho Power nor the IPUC had to deal with the consequences of timing differences between FAS 87 and cash contributions.

C. FAS 87-Based Recovery

Q. Why do the Joint Utilities continue to support using FAS 87 to recover pension costs?

A. FAS 87 provides a levelized expense over employees' approximate remaining service period, and provides recovery of the prepaid pension asset. In addition, as described above, FAS 87 is a time-tested methodology that smooths out costs over time.

Q. Please describe how FAS 87 levelizes the pension expense over an employee's service period.

A. A fundamental objective of FAS 87 is to recognize the compensation cost of an employee's pension benefits over the employee's approximate service period. In other words, using FAS 87, the company's pension cost is recovered in rates as an employee works and the company incurs a future pension expense associated with that employee.[6]

Q. Please describe how the return of the prepaid pension asset is provided through FAS 87 expense.

A. As we have previously described, the prepaid pension asset represents, by definition, the cumulative difference between cash contributions and cumulative FAS 87 expense. The cash contributions will eventually be recovered through FAS 87 expense, meaning that over the life of a pension plan the cumulative cash contributions will equal the FAS 87 expense. Thus, the current and future

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[6] Joint Testimony/200, Vogl/4.

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prepaid pension assets represent future costs that will be recovered through the FAS 87-based recovery currently in place. It is only the financing costs associated with the prepaid pension asset that are not currently recoverable under the current approach.

Q. Why do the Joint Utilities continue to advocate for FAS 87-based recovery and the inclusion of the prepaid pension asset in rate base?

A. First, our recommendation largely maintains the status quo. The only change we propose is to allow the recovery of the financing costs incurred to fund the cash contributions to the pension plan, which is not a fundamental change in the way that pension costs are recovered in rates. Inclusion of the prepaid pension asset in rate base simply recognizes that when the timing difference between cash contributions and FAS 87-based recovery exists, it is appropriate for the Commission to permit recovery of the financing costs resulting from that timing difference. On the other hand, switching to cash-based recovery, which is changing from accrual to cash accounting for pension cost recovery, represents a fundamental change in how pension costs are recovered in rates and creates the transitional issues described earlier in our testimony.

Second, our proposal requires no artificial adjustment to the amortization period for recovery of the prepaid pension asset. As described above, when using FAS 87-based recovery, the Joint Utilities recover their prepaid pension assets as the cash contributions are included in and smoothed by FAS 87 expense and recovered from customers. Unless the Commission prefers to reduce financing costs by shortening the time period over which the prepaid

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pension asset would normally be amortized through FAS 87 expense, there is no change to how the prepaid pension asset is recovered under our proposal.

D. Prudence

Q. Several parties raised concerns about the Joint Utilities' proposal, claiming that it would be necessary to review the prudence of each company's historical cash contributions before including the prepaid pension asset in rate base.[7] Do you agree?

A. No. The basis for recovery—whether FAS 87 expense or cash—has nothing to do with the prudence of the contributions; in other words, the Commission can review contributions for prudence regardless of the recovery approach. Thus, the need for a prudence review is not triggered by a change in the recovery methodology.

As previously described, the prepaid pension assets built up as each company complied with changes to federal law, which, together with the effects of the recession, required the utility to contribute more to its pension accounts than it was recovering through FAS 87 expense. Because the Commission has reset each company's FAS 87 recovery in the context of general rate cases, the contributions giving rise to the prepaid pension asset have already been subject to prudence reviews.

Moreover, even if the Commission concludes that subjecting utilities to a second historical prudence review is necessary, this docket is not the proper

[7] CUB/100, Jenks-McGovern/32 ("providing a return on prepaid pension assets requires us to go back in time and examine how that asset developed."); NWIGU-ICNU/100, Smith/36 (it is important to examine the prepaid pension asset, including funding decisions back to the inception of using FAS 87); Staff/100, Bahr/16 (prudence review would need to be applied retroactively).

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forum. This is a generic policy docket establishing the general ratemaking for pension costs. Any prudence review the Commission requires should be performed on a utility specific basis in individual rate proceedings.

Q. Assuming that the Commission requires a prudence review of contributions in individual utility dockets, what factors should the Commission review in those proceedings?

A. If the Commission conducts prudence reviews of the prepaid pension asset in utility-specific dockets, it should look at whether the cash contributions made by the utility conformed to its pension funding policies, GAAP, and the requirements of federal law. It is important to note that contributions exceeding the required minimums can have positive impacts on a company's pension plan by the plan's funded status, reducing potential premiums or penalties, and allowing for potentially higher plan asset returns. These results can benefit customers, even in a situation where the prepaid pension asset is included in rate base.

Q. Several parties recognize the complexity of reviewing the historical buildup of the prepaid pension asset[8] and suggest that the Commission avoid this task and instead simply "reset" the prepaid pension asset to zero.[9] Is this approach reasonable?

A. No. As we have pointed out in previous testimony and will discuss below, this approach is entirely unreasonable and would result in under-recovery of prudently incurred costs and lead to significant write-offs-.[10]

[8] CUB/100, Jenks-McGovern/32-38; Staff/100, Bahr/16-17.

[9] Staff/100, Bahr/22.

[10] Joint Utilities/300, Joint Parties/ 6-7.

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E. Clarification of Misconceptions.

Q. Staff has recommended that the prepaid pension asset included in rates be reduced by the amount that came about because of excess asset returns.[11] How do you respond to this recommendation?

A. Staff's proposal is unreasonable. As discussed in our earlier testimony, FAS 87 is a comprehensive methodology for measuring and spreading pension costs and is made up of several interrelated components. Modifying one element of FAS 87 in isolation and without addressing the effects of that change on other components would disrupt the purpose of FAS 87 and have unintended consequences. Moreover, under FAS 87-based recovery, investment returns, including any amounts exceeding those expected, benefit customers by reducing both future FAS 87 expense and future cash contributions. Additionally, excess asset returns are reflected in expense, thereby reducing the amount recovered from customers under FAS 87-based recovery.

Q. In its testimony and again at the July 10th workshop, CUB claimed that FAS 87 pension expense does not amortize the prepaid pension asset.[12] Is CUB correct?

A. No. The prepaid pension asset is defined as the difference between the cumulative cash contributions and the cumulative FAS 87 expenses.[13] As FAS 87 expense is incurred, the cumulative difference between cash contributions and FAS 87 expense decreases, which reduces, or "amortizes," the prepaid

[11] Staff/100, Bahr/24.

[12] CUB/100, Jenks-McGovern/19.

[13] Joint Utilities/ 200, Vogl/12.

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pension asset. In other words, simple math and the very definition of the prepaid asset make the result indisputable. The only circumstance under which FAS 87 would not totally amortize the prepaid pension asset is if the pension plan is terminated early, as discussed below.

Q. What happens if the plan ends early, (*i.e.*, before the last retiree receives her last payment)?

A. FAS 88 comes into play when an employer decides to settle or curtail a pension plan before the end of its natural life. As previously described, FAS 88 accelerates the recognition of expenses that would have been recognized in the future through FAS 87.[14] Instead of recognizing the pension expense over the entire natural life of the plan, under FAS 88 certain components of expense are recognized immediately. If FAS 88 is invoked, the cumulative cash contributions over the life of the plan will equal the sum of the cumulative FAS 87 expense and FAS 88 expense. Thus, FAS 87 and FAS 88 together will fully amortize the prepaid pension asset down to zero. In simple terms, FAS 88 kicks in only to recognize FAS 87 expense that would otherwise never be accounted for due to the termination of the plan before the "expensing" of the asset.

Importantly, any decision made by a utility to settle or terminate a plan early would be subject to a prudence review. Thus, any costs incurred by the utility through the triggering of FAS 88 would be included in customer rates only to the extent that the utility reasonably believed that the decision to terminate would benefit customers--- presumably through lower cost than would be incurred if the plan were allowed to continue to the end.

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[14] Joint Testimony/200, Vogl/5-6.

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F. Conclusion

Q. Please summarize the Joint Utilities' recommendation in this case.

A. The Joint Utilities continue to recommend that FAS 87 expense continue to be the basis for setting rates and that the Joint Utilities be allowed to recover their financing costs incurred to fund their pension plans. There is a timing difference between when the Joint Utilities are required to make cash contributions to their pension plans (governed by the Internal Revenue Code) and when the Joint Utilities recognize the contributions as an expense recoverable in rates (governed by GAAP). This timing difference has resulted in the Joint Utilities incurring a financing cost to fund their cash contributions. This financing cost is not currently recovered in rates.

Despite the impact of the timing differences between cash contributions and FAS 87 expenses, the Joint Utilities continue to support FAS 87-based pension cost recovery. FAS 87 is inherently less volatile than cash contributions, better matches pension costs over the period service is provided by the employee, and provides for recovery of the prepaid pension asset.

If the Commission moves to cash-based recovery, the current prepaid pension assets would need to be recovered in their entirety, just as they would be recovered if FAS 87-based recovery continues. If a switch to cash-based recovery does not include full recovery of the prepaid pension asset, the Joint Utilities would be assured of under-recovery of their pension costs over the life of the plan. This would trigger an unwarranted write-off that could be detrimental to the utility's financial stability.

Because of the complexity and uncertainty of moving to cash-based recovery and because of the benefits of using FAS 87 expense, the Joint Utilities

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continue to support the recovery of pension costs through FAS 87 expense-based recovery with the inclusion of the allowed return on the full prepaid pension asset to account for financing costs incurred in the course of prudent pension plan funding.

Q. Does this conclude your testimony?

A. Yes.

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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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