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March 28, 2016

## *Via Electronic Filing*

Public Utility Commission of Oregon  
Attn: Filing Center  
201 High St. SE, Suite 100  
Salem OR 97301

Re: In the Matter of PORTLAND GENERAL ELECTRIC COMPANY  
Application for Deferral Accounting of Excess Pension Costs and Carrying Costs  
on Cash Contributions  
**Docket No. UM 1623**

Dear Filing Center:

Enclosed for filing in the above-referenced docket, please find the Opening Brief of the Industrial Customers of Northwest Utilities.

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

Sincerely,

/s/ Jesse O. Gorsuch  
Jesse O. Gorsuch

Enclosure

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON**

**UM 1623**

In the Matter of	)	
	)	
PORTLAND GENERAL ELECTRIC	)	
COMPANY,	)	OPENING BRIEF OF THE
	)	INDUSTRIAL CUSTOMERS OF
Application for Deferral Accounting of Excess	)	NORTHWEST UTILITIES
Pension Costs and Carrying Costs on Cash	)	
Contributions.	)	
_____	)	

**I. INTRODUCTION**

Pursuant to the Administrative Law Judge’s prehearing conference memorandum in the above-referenced docket, the Industrial Customers of Northwest Utilities (“ICNU”) submits this opening brief. In this docket, Portland General Electric Company (“PGE” or the “Company”) seeks to defer, for later recovery in customer rates, \$16.4 million in expense associated with its pension plan that it incurred between 2012 and 2013. ICNU recommends that the Oregon Public Utility Commission (“Commission”) reject the Company’s application.

The Commission has found that “[d]eferred accounting is an exceptional form of ratemaking,”<sup>1/</sup> one that “should be used sparingly.”<sup>2/</sup> That is because deferred accounting is a departure from traditional rate regulation, as articulated in Federal Power Commission v. Hope Natural Gas Co.: “Under the statutory standard of ‘just and reasonable’ it is the result reached not the method employed which is controlling .... If the total effect of the rate order cannot be

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<sup>1/</sup> Re Northwest Natural Gas, Docket Nos. UM 1635 & UM 1706, Order No. 15-049 at 12 (Feb. 20, 2015).  
<sup>2/</sup> Re Commission Staff Request to Open an Investigation Related to Deferred Accounting, Docket No. UM 1147, Order No. 05-1070 at 10 (Oct. 5, 2005).

said to be unjust and unreasonable, judicial inquiry ... is at an end.”<sup>3/</sup> Following Hope and its progeny, the Commission sets a utility’s rates holistically in order to ensure that it has the opportunity to recover its costs of service and earn a reasonable return.<sup>4/</sup> Whether the utility under- or over-recovers a discrete component of its cost of service is irrelevant.

Deferred accounting, on the other hand, is specifically designed to allow recovery of a discrete portion of the utility’s cost of service, making it single-issue ratemaking.<sup>5/</sup> Deferred accounting ensures the utility has a means of being compensated for extraordinary costs it assumes in providing service to its customers and that could not otherwise be recovered through the normal ratemaking process. If it is overused, however, it has the potential to undermine traditional ratemaking by protecting utilities from normal business risks and unbalancing cost recovery to the detriment of customers.

The Commission, then, must answer one fundamental question in evaluating any application for deferred accounting that purports to match appropriately utility costs and customer benefits: Is it likely that the utility will not be able to recover the costs in question without deferred accounting, or is it likely that such costs will be recovered through long-term under- and over-forecasting inherent to the ratemaking process? Commission precedent establishes that deferred accounting may be appropriate for the former; it is not for the latter.<sup>6/</sup>

The expenses PGE seeks to recover in this case fall squarely within the latter circumstance – they are the product of a long-term cost of service that swings above and below

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<sup>3/</sup> 320 U.S. 591, 602 (1944); see also, Gearhart v. Pub. Util. Comm’n of Oregon, 255 Or. App. 58, 63 (2013) (“the validity of a particular determined rate is measured, not on the individual theories or methodologies used by the PUC, but on the ‘end result’ and whether it is just and reasonable”).

<sup>4/</sup> Re PGE, Docket Nos. UE 180/UE 184, Order No. 07-454 at 5 (Oct. 22, 2007); Re Northwest Natural Gas Co., Docket No. UG 221, Order No. 12-437 at 19 (Nov. 16, 2012).

<sup>5/</sup> Order No. 15-049 at 12.

<sup>6/</sup> Re PGE, Docket No. UM 1071, Order No. 04-108 at 9 (Mar. 2, 2004); Order No. 05-1070 at 7.

the amount in rates. That the Company's expenses during the applicable period were driven by a discount rate that had fallen to "historic lows" is of no moment.<sup>7/</sup> The issue is whether the actual costs the Company incurred as a result of this discount rate were so great as to effectively preclude cost recovery over the long-term. The record demonstrates that this is not so. A single year's accrued pension expense does not necessarily reflect the actual costs of PGE's pension plan, so it is inaccurate to claim that this expense appropriately matches the benefits customers receive from the plan. Furthermore, in prior years PGE has experienced negative pension expense in an amount that approaches the amount it seeks to defer in this docket. Granting deferred accounting for excess pension expense without giving customers the benefit of negative pension expense would result in asymmetrical cost recovery and undermine the holistic ratemaking process. The Commission should reject the Company's application.

## II. BACKGROUND

### A. Pension Accounting and Ratemaking.

As with other costs of service, PGE forecasts its pension expense in a general rate case and its actual expenditures may be greater or less than its forecast. The Commission has recently reviewed how PGE and other utilities account for their pension expenses.<sup>8/</sup> In UM 1633, the Commission evaluated a multi-utility (including PGE) proposal to include the "prepaid pension asset" in rate base.<sup>9/</sup> In rejecting that request, the Commission concluded, among other things, that the utilities' request "appears opportunistic and does not fairly reflect the history of

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<sup>7/</sup> PGE/100 at 8:4-6.

<sup>8/</sup> Re Commission Investigation in Treatment of Pension Costs in Utility Rates, Docket No. UM 1633, Order No. 15-226 at 2-4 (Aug. 3, 2015).

<sup>9/</sup> As the Commission explained, the prepaid pension asset represents "the financial accounting difference between actual contributions [to the pension trust] and the FAS 87 determined accruals." Id. at 3.

pension recovery under [Financial Accounting Standard (“FAS”)] 87. Prepaid pension assets and accrued pension liabilities fluctuate and are cyclical by nature.”<sup>10/</sup>

FAS 87 – the accounting method PGE uses to book pension expenditures – is an accrual method of accounting.<sup>11/</sup> What this means is that PGE books as an expense the cost of benefits its employees earn under the pension plan in the year those benefits are earned, rather than in the year the benefits are paid out.<sup>12/</sup> As a consequence, the actual cost of the benefits when the employee receives them is not necessarily (and very unlikely to be) equal to the expense that PGE booked in the year those benefits were accrued.<sup>13/</sup> The reason for this is that the amount of the accrual expense in a given year takes into account certain assumptions about future events, including interest costs, discount rates, actuarial assumptions and others.<sup>14/</sup> Thus, assume for instance that PGE’s FAS 87 expense in a given year was \$5 million. If in future years the Company realizes a higher return on the pension trust’s assets than it anticipated when it booked this \$5 million in FAS 87 expense, then, all other things being equal, future years’ FAS 87 expense will be lower in order to reflect the fact that the value of the pension trust is higher than originally anticipated. In essence, \$5 million in FAS 87 expense was higher than it needed to be, and future years’ FAS 87 expense will balance this out.

This difference between annual accrued FAS 87 expense and the ultimate costs of PGE’s pension plan is critical to resolving the issues in this docket. For purposes of matching pension costs and benefits, whether customers pay more or less than PGE’s FAS 87 expense in

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<sup>10/</sup> Order No. 15-226 at 9.

<sup>11/</sup> PGE/100 at 3:2-4. FAS 87 has been re-designated as Accounting Standards Codification (ASC) 715. For clarity, ICNU continues to refer to this standard as “FAS 87.”

<sup>12/</sup> Id. at 3:4-6.

<sup>13/</sup> ICNU/201, Vogl/3:2-3.

<sup>14/</sup> PGE/100 at 3:6-9; ICNU/201, Vogl/3:15-5:2; Order No. 15-226 at 2-3.

any given year is less important than whether the cumulative total customer payments over the life of PGE's pension plan are roughly equivalent to the cumulative total FAS 87 expense. This is because, as discussed above, FAS 87 expense attempts to estimate what the actual costs of benefits under the pension plan ultimately will be, taking into account future unknown circumstances including interest rates and return on assets.<sup>15/</sup> Annual FAS 87 expense does not reflect the ultimate costs of the pension plan; only cumulative FAS 87 expense does.<sup>16/</sup>

This is not to say that annual FAS 87 expense is not an actual cost to the Company. As PGE notes, it is just as liable for accrued expenses as it is for incurred expenses.<sup>17/</sup> It does mean, however, that for purposes of determining whether a deferral provides appropriate cost recovery, the Commission must look at the long-term over- and under-recoveries of FAS 87 expense in rates – as it did with the prepaid pension asset – rather than in isolated annual segments.

**B. PGE's request in this docket.**

The discussion above is relevant because, in this docket, PGE relies primarily on ORS 757.259(2)(e)'s allowance for a deferral if it “match[es] appropriately the costs borne by and benefits received by ratepayers” by seeking to defer for later recovery the difference between what it collected from customers in rates for its pension plan for part of 2012 and all of 2013 and its accrued FAS 87 expense over that same period.<sup>18/</sup> The total amount is \$2.9 million for 2012 and \$13.5 million for 2013.<sup>19/</sup> The Company claims that a deferral of these expenses is

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<sup>15/</sup> PGE/100 at 3:6-9; ICNU/201, Vogl/3:15-5:2; Order No. 15-226 at 2-3.

<sup>16/</sup> ICNU/201, Vogl/11:19-20.

<sup>17/</sup> PGE/200 at 16:18-17:21.

<sup>18/</sup> Id. at 3:11-12.

<sup>19/</sup> Errata to PGE/100 at 3:18-21.

appropriate because they were the direct result of a significant and unanticipated decline in the discount rate used as a component of FAS 87 expense to historic lows.<sup>20/</sup>

ICNU, Commission Staff, and the Citizens' Utility Board ("CUB") all object to the proposed deferral on both legal and policy grounds. Among other things, all three parties argue that the Company's deferral request inappropriately singles out a limited period in which the Company under-recovered its pension expense without recognizing the long-term balancing effects of annual under- and over-recoveries of this expense.<sup>21/</sup> Accordingly, all three parties recommend that the Commission reject the Company's deferral application.<sup>22/</sup>

### III. ARGUMENT

The Commission evaluates an application for deferred accounting in two phases.<sup>23/</sup> First, it considers whether it meets the statutory requirements for a deferral under ORS 757.259(2).<sup>24/</sup> If it does, then the Commission determines whether it should exercise its discretion to authorize the deferral.<sup>25/</sup> Meeting the statutory criteria is, of course, a threshold requirement: "if we find that a case meets our [discretionary] standards for granting deferral, we cannot authorize deferral unless the case also meets one of the subsection (a) to (e) criteria. Thus, meeting one of the subsection (a) to (e) criteria is a necessary but not a sufficient condition for granting a deferred accounting application."<sup>26/</sup> The Commission "may decide a case in the negative at either stage" of its review.<sup>27/</sup> Additionally, the applicant is "responsible for both the

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<sup>20/</sup> PGE/200 at 6:20-22, 8:3-4.

<sup>21/</sup> ICNU/100 at 6:13-7:13; Staff/100 at 11:3-12:11; CUB/100 at 6:21-10:2.

<sup>22/</sup> ICNU/100 at 7:15; Staff/100 at 2:3-5; CUB/100 at 18:17-21.

<sup>23/</sup> Order No. 05-1070 at 2.

<sup>24/</sup> Id.

<sup>25/</sup> Id. at 3.

<sup>26/</sup> Order No. 04-108 at 8.

<sup>27/</sup> Id.

burden of persuasion and the burden of production in support of a deferred accounting request.”<sup>28/</sup> While the burden of production “shifts to other parties to present evidence that rebuts what an applicant presented . . . the burden of persuasion always rests with the applicant, regardless of opposition to the filing.”<sup>29/</sup>

In this case, PGE has not met its burden to demonstrate either that its deferred accounting request meets the statutory requirements or that it satisfies the Commission’s discretionary criteria.

**A. The Company has not met its burden to demonstrate that its deferral minimizes the frequency of rate changes or fluctuations of rate levels or appropriately matches costs and benefits.**

PGE relies on ORS 757.259(2)(e) as the authority for its deferral application.<sup>30/</sup>

To satisfy its burden to demonstrate that its deferral request meets the requirements of this statute, PGE must show either that its request “minimize[s] the frequency of rate changes or the fluctuation of rate levels or [] match[es] appropriately the costs borne by and benefits received by ratepayers.”<sup>31/</sup> “Whether either of these standards is satisfied requires an examination of the facts presented on a case-by-case basis.”<sup>32/</sup>

Under the first standard, “whether a deferral will minimize the frequency of rate changes depends primarily on the size of the cost to be deferred and the utility’s options for rate filings, including requests for interim rate relief.”<sup>33/</sup> The Company makes a cursory attempt to argue that its deferral meets this standard, claiming that the alternative to a deferral was to file

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<sup>28/</sup> Order No. 05-1070 at 5.

<sup>29/</sup> Id.

<sup>30/</sup> PGE/200 at 3:6-13.

<sup>31/</sup> ORS 757.259(2)(e).

<sup>32/</sup> Order No. 05-1070 at 5.

<sup>33/</sup> Id.

for interim rates in 2012 and 2013.<sup>34/</sup> The Commission, however, may only authorize interim rates during the suspension period in which it is investigating the justness and reasonableness of a rate application.<sup>35/</sup> PGE submitted no application for new rates effective in 2012 or 2013.<sup>36/</sup> Furthermore, “Commission policy is to grant interim rate relief only where the utility demonstrates that it faces severe financial distress that jeopardizes the continuing operation of the utility.”<sup>37/</sup> PGE has made no attempt to argue that could have met this threshold. Thus, it was neither possible nor justified for the Commission to authorize interim rates in 2012 or 2013. Instead, authorizing the Company’s deferral will lead to *greater* fluctuations in rate levels because it will increase the amount the Company collects from customers in a future ratemaking proceeding when the deferred amounts are amortized.

Perhaps recognizing these problems, PGE relies primarily on its deferral’s ability to match appropriately costs and benefits.<sup>38/</sup> The Company states that its pension plan enables it to retain the highly skilled workforce necessary to provide safe and reliable service to its customers.<sup>39/</sup> Thus, it identifies the benefits its pension plan provides to customers. Next, the Company issues the conclusory statement that “PGE incurs annual pension expense as the direct result of providing market-based competitive post-retirement benefits to employees.”<sup>40/</sup> No doubt. And PGE forecasted the amount of this expense in its rates, which customers paid.

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<sup>34/</sup> PGE/200 at 4:10-11.

<sup>35/</sup> ORS 757.215(5).

<sup>36/</sup> ICNU/100 at 2:3-7.

<sup>37/</sup> Re PGE, Docket No. UE 204, Order No. 09-108 at 3 (March 30, 2009).

<sup>38/</sup> PGE/200 at 3:11-12.

<sup>39/</sup> Id. at 3:16-20.

<sup>40/</sup> Id. at 3:15-16.

Presumably there are all sorts of other costs PGE under-collected from customers in 2012 and 2013, and others that it over-collected. That is the nature of ratemaking.<sup>41/</sup>

The Company's burden of proof and persuasion in a deferral request is not simply to identify that it collected more or less of a particular expense than was forecasted in rates. It must demonstrate that its deferral "appropriately" matches costs and benefits.<sup>42/</sup> In addition to the fact that the Commission, like a court, "should interpret statutes and rules so as to give meaning to every word,"<sup>43/</sup> this word must have some significance in the statute, otherwise any request for deferral of a cost that was different from the forecast would meet the statutory requirements.

In this case, PGE has not demonstrated how or why its deferral "appropriately" matches costs and benefits. For one, by refraining from filing a rate case in 2011 or 2012, the same low discount rate the Company blames for its high pension expenses in 2012 and 2013 likely also benefitted the Company in other areas. While financing costs were declining, the Company retained a 10% return on equity ("ROE") over these years.<sup>44/</sup> When the Company did file a rate case in 2013, it agreed to reduce its ROE to 9.75% for 2014.<sup>45/</sup> As ICNU's witness, Bradley Mullins, showed, if PGE's ROE had been at 9.75% in 2012 and 2013, customers would have saved approximately \$5.8 million each year.<sup>46/</sup> External circumstances like low interest rates, in other words, often have both positive and negative consequences. The Company is

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<sup>41/</sup> See Hope, 320 U.S. at 602.

<sup>42/</sup> ORS 757.259(2)(e).

<sup>43/</sup> Due-Donohue v. Beal, 191 Or. App. 98, 101 (2003); In re Holmlund's Estate, 232 Or. 49, 67 (1962); Re Honeywell Int'l, Inc., Docket No. DR 40, Order No. 08-388 at 12 (July 31, 2008).

<sup>44/</sup> ICNU/102 at 3.

<sup>45/</sup> Id.

<sup>46/</sup> ICNU/100 at 4:5-11.

seeking here to insulate itself from the negative while simultaneously benefitting from the positive.

Furthermore, as discussed above, simply because FAS 87 expense in a given year is higher than that included in customer rates does not mean that customers are underpaying for the costs of the Company's pension plan. One year's FAS 87 expense is merely a prediction of the ultimate costs of the benefits earned in that year.<sup>47/</sup> Thus, whether customers are underpaying or overpaying for the costs of the pension plan must be viewed over the long term – when the effects of interest rates, rates of return, and other components of FAS 87 can be discerned – not in isolated annual segments. Between 2003 and 2011, PGE's cumulative FAS 87 expense was \$4 million *less* than it collected in rates.<sup>48/</sup> This flipped in 2012 and 2013, but after the Commission authorized new rates for the Company effective in 2014, the Company again over-collected FAS 87 expense from customers by \$3.5 million.<sup>49/</sup> Between 2003 and 2004, the Company booked negative FAS 87 expense of \$11.1 million without sharing any with customers.<sup>50/</sup> Whether customers ultimately have overpaid or underpaid for the costs of PGE's pension plan will not be known until all of the costs of the pension plan have been paid. It is not accurate – and certainly not sufficient to meet the Company's burden of proof – simply to assert that customer rates have not appropriately matched costs and benefits of the pension plan because those rates were lower in one year than the Company's actual expenses.

PGE may argue that this standard effectively makes it impossible for it to satisfy its burden of proof. If the ultimate costs of the pension plan will not be known until the plan is

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<sup>47/</sup> PGE/100 at 3:4-6; ICNU/201, Vogl/3:2-3, 4:2-6.

<sup>48/</sup> ICNU/102 at 1-2.

<sup>49/</sup> Id.

<sup>50/</sup> Id.

closed out, the Company may protest that there is no way to show that a deferral of pension expenses while the plan is still active appropriately matches costs and benefits. But that is not so. It simply means that the Company should not be able to defer expenses that result from nothing more than the fluctuations of FAS 87 expense – whatever the causes of those fluctuations – unless the financial impact to the Company is so great as to make it unlikely that it will recover the costs through these long-term fluctuations. There could be other justifications for a deferral of pension expenditures, however; for instance, if there are material changes to the accounting standard, or if a law is passed that otherwise impacts the costs of the Company’s pension plan. Such circumstances were, in fact, the basis for a PacifiCorp deferral when it switched from cash to accrual accounting.<sup>51/</sup> As discussed below, these are examples of what the Commission has called “scenario” risks for which deferred accounting may be more appropriate, as opposed to the type of “stochastic” risk the Company experienced here.<sup>52/</sup>

Deferred accounting should be used almost exclusively for one-off situations in which the utility incurs an unanticipated significant expense that benefits its customers. That is a situation in which a deferral has the potential to “appropriately” match costs and benefits.<sup>53/</sup> Deferrals of the type the Company requests in this case – where amounts included in customer rates fluctuate above and below actual annual expenses – should, on the other hand, be exceedingly rare. Similar to what the Commission found in UM 1633 with respect to the prepaid pension asset, over- and under-recovery of FAS 87 expense is “cyclical by nature.”<sup>54/</sup> The Company’s complaint that, for a limited time period, it recovered less of a long-term cost of

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<sup>51/</sup> Re PacifiCorp, Docket No. UM 540, Order No. 93-354, 141 P.U.R.4th 520 (Mar. 19, 1993).

<sup>52/</sup> Order No. 04-108 at 8-9; Order No. 05-1070 at 6-7.

<sup>53/</sup> ORS 757.259(2)(e).

<sup>54/</sup> Order No. 15-226 at 9.

service in rates than its actual expenses simply is not good enough to meet its burden to demonstrate that its deferral “appropriately” matches costs and benefits.

**B. The Company’s deferral does not satisfy the Commission’s discretionary criteria.**

Even if the Commission concludes that the Company has satisfied its burden to demonstrate that its deferral meets the requirements of ORS 757.259(2)(e), PGE must also show that its deferral meets the Commission’s discretionary criteria.<sup>55/</sup> In Order No. 04-108, the Commission, in the context of a power cost deferral, adopted Staff’s distinction between two types of risks that could lead to under-recovery of costs: risks referred to as “stochastic risks” and those referred to as “paradigm or scenario risks.”<sup>56/</sup> The former are “risks that can be predicted as part of the normal course of events,” while the latter are “those that are not susceptible to prediction and quantification.”<sup>57/</sup> In Order No. 05-1070, the Commission extended this distinction of risks beyond power costs and applied it to deferrals of all types of costs.<sup>58/</sup>

The distinction between stochastic and scenario risks matters because the financial effect on the Company must be greater in order to justify deferral of a stochastic risk as opposed to the impact of a scenario risk:

If the event was modeled or foreseen, without extenuating circumstances, the magnitude of harm must be substantial to warrant the Commission’s exercise of discretion in opening a deferred account. If the event was neither modeled nor foreseen, or if extenuating circumstances were not foreseen, then the magnitude of harm that would justify deferral likely would be lower.<sup>59/</sup>

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<sup>55/</sup> Order No. 04-108 at 8; Order No. 05-1070 at 2-3.

<sup>56/</sup> Order No. 04-108 at 8-9.

<sup>57/</sup> Id. at 8.

<sup>58/</sup> Order No. 05-1070 at 7.

<sup>59/</sup> Id.

Thus, in exercising its discretion to authorize a deferral, “[f]irst, the Commission will examine the triggering event that led to the deferral application” in order to determine whether it qualifies as a stochastic risk or a scenario/paradigm risk.<sup>60/</sup> “The utility bears the burden of identifying the event and showing its significance.”<sup>61/</sup>

1. The triggering event in this case is a stochastic risk.

PGE argues that the primary triggering event in this case was the “unexpected, significant, and continuing decline in the discount rate used to determine annual pension expense.”<sup>62/</sup> Based on this, the Company concludes that the event leading to the deferral falls outside the predictable and quantifiable, meaning that it is a “scenario or paradigm risk” requiring PGE only to show that the financial impact of the event is material, as opposed to substantial.<sup>63/</sup> Staff’s testimony, however, shows that PGE has experienced similar variability in the discount rate and in its overall returns in prior years.<sup>64/</sup> The Company criticizes Staff for failing to give what it views to be appropriate weight to the fact that the discount rate dropped to historic lows.<sup>65/</sup> It “is the magnitude and direction of variability” in the discount rate that transforms the risk the Company faced from stochastic to scenario in nature, it argues.<sup>66/</sup>

PGE’s argument misses the point. Fundamentally, whether costs are the product of a scenario or stochastic risk depends upon whether the utility is likely to be able to recover such costs without deferred accounting:

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<sup>60/</sup> Id.  
<sup>61/</sup> Id.  
<sup>62/</sup> PGE/200 at 6:20-22.  
<sup>63/</sup> Id. at 6:1-17.  
<sup>64/</sup> Staff/100 at 7:15-12:11.  
<sup>65/</sup> PGE/200 at 19:11-13.  
<sup>66/</sup> Id. at 19:15-16 (emphasis in original).

The financial threshold for deferred accounting is lower for the scenario or paradigm risk because the effect of that type of risk is not likely to fluctuate as the stochastic risks do. Hydro variability, for example, causes costs to swing above and below the average included in rates, so the effect should average out. For paradigm or scenario risks, there is no likelihood that a cost swing will be balanced out over time.<sup>67/</sup>

Risks, in other words, relate to the cost itself, not to the components of the cost. For purposes of deferred accounting of pension expenses, the “risk” PGE faces is that in any given year it will not recover in rates the full expense. To determine whether the risk is stochastic or scenario in nature, the question to ask is what *cost* is the Company requesting to defer? If PGE had to change the way it accounted for its pension plan, then a deferral would relate to the cost of the accounting change, a cost that, depending on the circumstances and its significance, may be unlikely to be recovered in rates absent a deferral – a scenario risk.

Here, however, the cost PGE is requesting to defer is simply higher-than-expected FAS 87 expense.<sup>68/</sup> There was no fundamental change in pension accounting, no one-off scenario that is wholly independent of the inherent fluctuations of long-term costs. While PGE may have faced an “historically low” discount rate, the risk associated with that discount rate was still nothing more than the fact that its FAS 87 expense would be greater than projected. This is a “stochastic risk” as the Commission has defined it for purposes of deferred accounting.<sup>69/</sup> Even a “significant” decline in the discount rate to “historically low” levels will

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<sup>67/</sup> Order No. 04-108 at 9.

<sup>68/</sup> PGE/100 at 3:17-4:2.

<sup>69/</sup> PGE provides its own definition of “stochastic” in its testimony and argues that FAS 87 expense is not subject to stochastic modeling, the implication being that fluctuations in FAS 87 expense are not a stochastic risk. PGE/200 at 20:18-21:15. Regardless of how PGE defines the term, though, the Commission has been clear as to what is a “stochastic risk” for purposes of deferred accounting, and fluctuations in FAS 87 expense fall squarely within that definition. Order No. 04-108 at 8-9; Order No. 05-1070 at 6-7.

allow the Company to recover any under-collection of expenditures through the long-term forecasting process inherent in ratemaking if the under-collection associated with that decline is not so substantial as to make such recovery unlikely.<sup>70/</sup> PGE, therefore, must show that the financial effect of its under-recovery was substantial.

2. The financial impact to PGE of higher pension expense in 2012 and 2013 was not substantial.

In evaluating the impact of deferred costs, the Commission looks to “the magnitude of harm,”<sup>71/</sup> that is, “the financial effect on the utility.”<sup>72/</sup> PGE is seeking to defer \$2.9 million in pension expense for 2012 and \$13.5 million for 2013.<sup>73/</sup> Far from constituting the “substantial” financial impact necessary to justify deferral of costs associated with a stochastic risk, the amounts PGE seeks to defer here do not even rise to the “material” level associated with scenario risks.

In looking at the “magnitude of harm” to the utility, the Commission has reviewed the impact of the costs on the utility’s overall return on equity (“ROE”).<sup>74/</sup> Staff calculated that the proposed deferral amounts for 2012 and 2013 on the Company’s ROE were 18 basis points and 86 basis points, respectively.<sup>75/</sup> PGE, on the other hand, largely ignores the financial impact of the deferred costs. Instead, it asserts, incorrectly, that it “is required to demonstrate that the magnitude of our *deferral request* is material,”<sup>76/</sup> as opposed to its financial impact on the Company.

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<sup>70/</sup> Order No. 04-108 at 9.  
<sup>71/</sup> Order No. 05-1070 at 7.  
<sup>72/</sup> Order No. 04-108 at 9.  
<sup>73/</sup> PGE/100 at 3:18-21.  
<sup>74/</sup> Id.  
<sup>75/</sup> Staff/100 at 15:5-7.  
<sup>76/</sup> PGE/200 at 13:2-3 (emphasis added).

The difference between the Company's language and the language of the Commission's orders is significant because it leads the Company to support its argument with irrelevant data. PGE asserts, for instance, that its 2013 pension expense was "approximately 265% over the amount set in prices."<sup>77/</sup> Percentages, however, can be subjective. In its 2015 general rate case, PGE budgeted \$127,000 for a Company picnic, \$32,000 of which was included in rates.<sup>78/</sup> If the Company somehow managed to prudently and unexpectedly exceed its forecasted budget by 300%, surely the Commission would not authorize the Company to defer \$64,000 for later recovery in rates based on a finding that this amount was material or substantial.<sup>79/</sup> Again, the relevant impact is the overall financial impact on the Company, not the amount by which a particular expenditure exceeded the forecast.

Next, the Company notes that it highlighted the impact of increased pension expense on its net income in its 2012 and 2013 SEC Form 10-Ks.<sup>80/</sup> The problem with this argument is that the Company said exactly the same thing in its 2014 10-K,<sup>81/</sup> a year in which it *over-collected* pension expense from customers by \$3.5 million (more, even, than the \$2.9 million it is seeking to defer for 2012).<sup>82/</sup> Furthermore, the fact that PGE said in its 10-Ks that increased pension expense "contributed to the decrease in net income" is no basis on which to determine whether these increased expenditures are "material" or "substantial."<sup>83/</sup>

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<sup>77/</sup> PGE/200 at 13:9-12.

<sup>78/</sup> Docket No. UE 294, Staff/1300 at 11:9-20. Pursuant to OAR 860-001-0460(1)(d), ICNU requests that the Commission take official notice of this exhibit.

<sup>79/</sup> That is, three times the \$32,000 included in rates, minus the amount already recovered.

<sup>80/</sup> PGE/200 at 14:3-5.

<sup>81/</sup> ICNU/200 at 6.

<sup>82/</sup> ICNU/102 at 2; PGE/100 at 3:20.

<sup>83/</sup> ICNU/200 at 2, 4, 6.

Finally, the Company alleges materiality based on the percentage the deferred amounts represent of its net income.<sup>84/</sup> For 2013 it was 13 percent.<sup>85/</sup> Again, percentages can be misleading. The reason the deferral for 2013 reaches 13 percent is because the Company's net income was unusually low in that year due to a number of circumstances, including a \$9 million over-billing refund to a customer, \$17 million in increased power cost expenses due to a prolonged forced outage at the Colstrip Generating Station, and a \$52 million write-off for expenses associated with the Cascade Crossing Transmission Project, which the Company abandoned.<sup>86/</sup> Without these additional expenses, the Company would have had a net income of \$183 million, and the pension expenses PGE seeks to defer for that year would have constituted 7.3 percent.

Percentages, in other words, allow one to play with the numbers to make an expense look large or small. That is why the Commission has not judged the financial impact of a deferral based on the percentage of net revenue it represents; it has judged it based on the impact to ROE, an objective and static measurement that identifies the true impact of an expense to a utility's earnings.

Here again, PGE fails in its burden of proof. The Company makes no attempt to argue what impact to its ROE would constitute a "material" impact and, therefore, does not demonstrate that either the 18 basis point impact in 2012 or the 86 basis point impact in 2013 are material. Commission orders have used 250 basis points as an example of a financial impact that did not qualify as the "substantial" impact necessary for deferral of costs associated with

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<sup>84/</sup> PGE/200 at 14:8-10.

<sup>85/</sup> Id.

<sup>86/</sup> ICNU/103.

stochastic risks, but have not established guidelines for what might constitute a “material” impact.<sup>87/</sup> ICNU accepts, though, that it is some amount that is less than the “substantial” impact required for stochastic risks. Even so, 86 basis points should not qualify. It is well established that there is a range of reasonable returns for a utility,<sup>88/</sup> and that range can be 100 basis points or more (i.e., 50 basis points above or below a midpoint). In its last general rate case, for instance, the Company’s cost of capital witness identified a range of reasonable returns that was 140 basis points.<sup>89/</sup> Thus, if PGE were earning at the top of a reasonable range and experienced a cost that reduced its ROE to the bottom of a reasonable range, it would still be earning a reasonable return. The financial impact of an increased expense that does not exceed this range, therefore, should not be considered material. PGE has not demonstrated otherwise.<sup>90/</sup>

In any event, whether 86 basis points constitutes a “material” impact is irrelevant because it is plainly not the type of “substantial” impact necessary to justify deferral of the type of expenditure at issue here. While the Commission has not established a bright line threshold for what constitutes a substantial impact, it has provided a previous example in which it declined

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<sup>87/</sup> Order No. 04-108 at 9.

<sup>88/</sup> Re PGE Request for a General Rate Revision, Docket Nos. UE 180/UE 181/UE 184, Order No. 07-015 at 26 (Jan. 12, 2007). In adopting a power cost adjustment mechanism for PGE in this order, the Commission established an earnings test deadband of 100 basis points above and below the Company’s authorized ROE (i.e., 200 basis points total). It is well established that power cost variation represents a stochastic risk for which there must be a substantial financial impact to justify a deferral. Order No. 04-108 at 9. Therefore, it would be reasonable for the Commission to identify 100 basis points (one-half of the power cost deadband and less than half of the “substantial” 250 basis point financial impact the Commission has previously used to guide deferred accounting of stochastic risks) as a rule of thumb for what constitutes a financial impact that qualifies as “material” for purposes of deferred accounting.

<sup>89/</sup> Docket No. UE 294, PGE/1100 at 2:2-3 (finding reasonable range of returns to be between 9.8% and 11.2%).

<sup>90/</sup> PGE may argue that its earned ROE for 2013 was 6.43%, as opposed to an authorized ROE of 10% and, therefore, its earnings were more than 50 basis points below its authorized ROE. That issue, however, relates to the earnings test the Commission performs upon amortization of a deferral it has already authorized. The question here is whether the impact of the expense on ROE is “material” enough to justify a deferral in the first place. The Company’s earned ROE during the deferral period is irrelevant to that question.

to authorize deferral of costs that had a 250 basis point impact.<sup>91/</sup> The Commission determined that this deadband “represented risks assumed, or rewards gained, in the course of the utility business.”<sup>92/</sup> The particular basis point threshold, however, is less important than the principle underlying it. That is, a large basis point impact is necessary to justify deferral of costs related to stochastic risks because these costs “swing above and below the average included in rates, so the effect should average out.”<sup>93/</sup> Only if the financial impact is so great as to make such averaging unlikely should a deferral be authorized.

Instead of addressing this rationale underlying the 250 basis point threshold the Commission has previously used to guide deferrals of costs associated with stochastic risks, the Company attempts to meet the “substantial” requirement through a bizarre and misguided attempt to translate that 250 basis point impact into pension expense, again by using percentages. The Company notes that the Commission’s 250 basis point example was in the context of power costs.<sup>94/</sup> It then states that \$39 million in increased costs would result in a 250 basis point reduction to its ROE.<sup>95/</sup> This amount represents approximately 6% of its annual power costs, but would represent approximately 700% of its annual FAS 87 expense, the Company states.<sup>96/</sup> To extend the analogy even further, PGE might note that \$39 million also represents over 30,000% of the amount it expected to spend on its Company picnic.<sup>97/</sup> But so what? The issue is not what percentage of a particular expense represents a 250 basis point impact, it is whether the *actual* basis point impact from the *actual* expense incurred is substantial enough that the impact is not

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<sup>91/</sup> Order 04-108 at 9.

<sup>92/</sup> Id.

<sup>93/</sup> Id.

<sup>94/</sup> PGE/200 at 14:15-21.

<sup>95/</sup> Id. at 15:6-8.

<sup>96/</sup> Id. at 15:6-12.

<sup>97/</sup> Docket No. UE 294, Staff/1300 at 11:9-20.

likely to average out over time. If PGE had incurred \$39 million in FAS 87 expense in 2013, then perhaps it would have a reasonable argument for a deferral. But it did not; it incurred \$18.6 million, \$13.5 million of which exceeded the amount in customer rates, an amount that represents an 86 basis point impact to its ROE.<sup>98/</sup>

PGE has provided no evidence to suggest that this is an amount that will not balance out over time. Indeed, the evidence indicates otherwise. It shows that, between 2003 and the deferral period, PGE over-collected FAS 87 expense from customers in the aggregate.<sup>99/</sup> Between 2003 and 2004, the Company booked negative FAS 87 expense of over \$11 million, none of which it shared with customers.<sup>100/</sup> It is unclear why the Company should get this benefit but not have to bear the risk of costs going the other way on occasion. Again, FAS 87 expense, while it must be booked annually, is nothing but a prediction of ultimate pension costs. The Company has provided no reason to believe that its under-recovery of FAS 87 expense in 2012 and 2013 will deny it the ability to fully recover its pension costs from customers over the life of the plan.

#### IV. CONCLUSION

For the foregoing reasons, ICNU recommends that the Commission deny the Company's application to defer for later ratemaking treatment excess FAS 87 expense in 2012 and 2013. Authorizing deferral of these amounts would ignore the long-term cost impacts of FAS 87 expense and risk authorizing asymmetrical rate recovery to the Company's benefit.

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<sup>98/</sup> PGE/100 at 3:17-20; Staff/100 at 15:5-7.

<sup>99/</sup> ICNU/102 at 1-2.

<sup>100/</sup> ICNU/102 at 1.

Dated this 28th day of March, 2016.

Respectfully submitted,

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