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.	)

ALL PARTY REBUTTAL TESTIMONY OF THE
CITIZENS' UTILITY BOARD OF OREGON

Wednesday, March 12, 2014

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Our names are Jaime McGovern and Bob Jenks, and our qualifications are listed in CUB Exhibit 101.

I. Introduction

CUB responds to Staff's Reply Testimony in UM 1633 on the issue of the prepaid pension asset.

We first address the evolution in terminology. In UE 262, PGE introduced the term "prepaid pension asset." Previously, in its 10-k, PGE had used the term "prepaid pension cost" (liability) to inform investors.[1] CUB believes that this language inconsistency was significant and appreciates Staff's comprehensively defining and utilizing terminology that represents the cumulative balance, both when it is positive (prepaid pension asset) and when it is negative (accrued pension liability), by coining the

[1] Portland General Electric. (2006, March 15). *Form 10-k*. Retrieved from http://www.sec.gov/Archives/edgar/data/784977/000078497706000019/frm10k05.htm.

term "ppa/apl" (prepaid pension asset/accrued pension liability). This is important because Idaho Power currently has an accrued pension liability and all of the Joint Utilities have had an accrued pension liability in the past.[2] Because each of the utilities sometimes have had a prepaid pension asset and at other times have had an accrued pension liability, it is important to recognize that these are the same animal whether positive or negative. CUB will adopt Staff's terminology, which is not only consistent, but fair. CUB, however, also believes that the symmetrical treatment of the ppa/apl should not end with the terminology, but should follow through to the ratemaking treatment. CUB insists that accrued pension liabilities (assets to customers) must receive equal treatment to that of prepaid pension assets, both historically, and going forward. Staff addresses this issue of consistency in its recommendation.

Staff begins its Reply Testimony with a statement of its primary position:

> Staff's primary recommendation is to disallow the inclusion in rate base of any of the current prepaid pension asset / accrued pension liability (ppa/apl) account balance.[3]

CUB supports this position of Staff. Staff then goes on to discuss other issues in UM 1633, including (1) the treatment of deferred tax benefits associated with the prepaid pension asset (2) treatment of the ppa/apl going forward versus treatment of the ppa/apl retroactively (3) and, for the Commission, options and alternative pension recovery treatment other than that requested in UM 1633 by the Joint Utilities.

CUB believes that any change in ratemaking treatment (re: pensions) should be supported by (1) evidence of improved fairness and (2) improved accuracy/adherence to the law (we'll refer to this as the two part test for the rest of this testimony). In that light,

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[2] UM 1633/CUB/Exhibits 102, 103, 104, 105, 106, and 107.
[3] UM 1633 Staff/100/Bahr/2, lines 1-3.

CUB supports Staff with regard to historic ppa/apl, which is to "disallow the inclusion in rate base of any of the current prepaid asset/accrued pension liability (ppa/apl) account balance."[4] This, combined with Staff's proposal to continue FAS 87 as the basis for ratemaking, is a package with which CUB agrees. CUB believes that this position is principled, and has sound economic justification.

CUB, does not, however, support either (1) partial inclusion of the ppa/apl going backward or (2) inclusion of the ppa/apl going forward, as neither of these potential modifications to current ratemaking treatment meets the two part test mentioned above. Segmenting the ppa/apl and including the ppa/apl in rates, going forward or backward, has many, logistical and economical, problems, which we will discuss below.

CUB also believes that the companies have had, since the passage of SB 967,[5] the responsibility, to pass through to customers, the deferred tax implications associated with the prepaid pension asset.

CUB'S testimony is organized as follows:

1. CUB agrees with Staff on the recommendation to deny the return on the historical prepaid pension asset, on the basis that this position (a) is balanced and fair (b) is simple to execute (c) retains the current ratemaking treatment, for which the companies asked, and to which the Commission agreed (d) satisfies the two part test. Moreover, CUB believes that (e) the Joint Utilities have not met the burden of proof to demonstrate that they deserve additional revenues to recover a return on the prepaid pension asset.

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[4] UM 1633 Staff/100/Bahr/2, lines 1-3.
[5] S.B. 967, 76th Or. Leg. Ass., Reg. Sess. (Or 2011).

2. CUB differs with Staff on how to treat (a) the tax deferred benefit of the ppa/apl (b) the prospective ppa/apl (the ppa/apl going forward) and (c) alternative allowances for the Companies to recover on the ppa/apl retroactively.

II. Staff's recommendation to deny the recovery on the ppa/apl retroactively

CUB supports the Staff recommendation to deny the Joint Utilities a return on the prepaid pension asset, recognizing that such a policy decision will also prevent customers of Idaho Power from receiving a return on the accrued pension liability of Idaho Power. We detail the rationale for our support below.

A. Granting recovery doesn't satisfy the two part test.

The Joint Utilities are requesting alteration of the treatment for pension recovery in rates at a time when the outcome of such a change would have a significantly disproportional effect. Originally, the utilities used cash accounting to recover pension costs. When the FAS 87 order came out, and the companies chose to adopt it for ratemaking treatment, they relinquished the cash accounting recovery treatment that had been in effect. But as detailed in CUB’s Reply Testimony, the various utilities regulated by this Commission have been inconsistent in their use of FAS 87. For example, it was not uncommon for companies to charge customers for FAS 87 when it was a cost, but to withhold it from customers when it was a credit. There were many years where it would have been harmful for the companies to be under a ratemaking treatment where ppa/apl earned a recovery for the creditor (ratepayers in the case of apl). In addition, there are many more years where FAS 87 expense was negative for the companies, accruing and helping to and grow the prepaid pension asset, converting it from an accrued pension liability to a prepaid pension asset. Yet, the Joint Utilities did not request that the ppa/apl earn a return until now. Granting this request, at this juncture, would provide positive reinforcement for those seeking to affect strategic timing of single issue ratemaking issues. In addition, because much of the current ppl/apl was caused by negative FAS 87 expense that was not passed through to customers, asking customers to pay a return on the ppl/apl today would be unfair.

Not only would fairness be compromised if companies were granted recovery on the prepaid pension asset, but the Commission would lose ground in the arena of reporting accuracy. Although the companies are required to report FAS 87 expense for accounting purposes, there is no requirement for them to use FAS 87 as a basis for ratemaking and it has been inconsistently applied in the past. Not only have some of the Joint Utilities not used FAS 87 when it is negative, many rate cases have been silent as to the basis for the approved level of pension cost in rates (such as rate cases with black box settlements). Because the ppl/apl represents the accumulation of the difference between cash accounting (contributions) and accrual accounting (FAS 87), the lack of a consistent application of FAS 87 for ratemaking purposes makes it impossible to identify the accuracy of the level of ppl/apl that should be used for ratemaking purposes.

B. Granting recovery would result in retroactive ratemaking.

The fact is that the prepaid pension asset/accrued pension liability is a historical entity. It is a tally that the companies have individually recorded since the inception of FAS 87 and the accounting requirements that FAS 87 imposed. Moreover, as CUB has previously mentioned, the companies have not treated this historical ppa/apl symmetrically, and as we discuss below, the lack of access to reliable records further impedes the prudence review required before recovery of any resource. Allowing recovery of the prepaid pension asset would require single-issue, retroactive ratemaking to determine the prudent level of ppa/apl that exists for ratemaking purposes. In addition, the lapse of significant time between the period of accumulation of this asset (liability), and requested recovery, creates large logistical hurdles in data recovery.

CUB believes strongly that it is the companies' burden of proof to demonstrate not only whether a particular resource is prudent and eligible for recovery, but also the amount of recovery. In this case, the Companies have failed to demonstrate that the asset/liability is prudent and eligible for a rate of return, and if it were eligible for a rate of return, then how much should be eligible for a rate of return. In response to CUB DR 5, several companies have cited lack of information in regards to the origination of FAS 87 expenses, annual ppa/apl amounts and transitional expenses.[6] CUB does not see how, if the companies are unable to produce the necessary information in this investigatory docket, that they will be able to suddenly produce it for the prudence review docket, when even more time will have elapsed. Even if parties were able to fill in the missing data, CUB argues that the companies would be unable to reliably prove that the charges were relevant and prudent. Examples of complications for prudence review abound: (1) transfer of company ownership, mergers and buyouts (2) prudency of pension termination (3) prudency of decisions to fund above the minimum (4) prudency of pension plan manager choice and (5) "black box" settlements with the OPUC, to name a few. All of these issues, among others, would need to be investigated, discussed, and settled in order to determine the level of return on the historical ppa/apl even if this docket were to approve such a return. CUB believes that the Joint Utilities, in asking for a return at this

[6] *See* UM 1633 CUB Exhibits 102-107.

delayed date, have now created a logistical burden that other parties, including the ratepayers, should not have to bear.

CUB sees several issues at stake here: first, whether, as a practice, the accounting items that are decades old are eligible for a change in regulatory treatment allowing for a return on decades old dollars, especially given the fact that during that time, the company was aware of the accruing balance the entire time and never asked for a rate of return, and second, if indeed, those items are eligible for review, whether the lapse of time has made prudence review unduly burdensome.

Because the companies did not address this for decades while the ppa/apl was accruing, the interested parties did not have a chance to review the facts in a timely and accurate manner. Moreover, the ratepayers who may be saddled with the cost, or granted the credit, in the case of an apl, are not the same ratepayers who benefited from the services provided. Granting recovery isn't a practicable option because of the lack of reliable information. The lack of reliable information makes an in-depth prudence review clearly impossible. CUB reminds the Commission that it is the companies who must carry the burden of proof in any prudence review.

III. Staff's recommendation to condition the pass through of the deferred tax benefit on rate recovery

Staff's proposed treatment of the deferred tax benefit is contingent on the ppa/apl recovery treatment. CUB disagrees with this conditional treatment, and instead believes that it is the Commission’s legal responsibility to verify that all of the companies pass through all of the tax benefits to ratepayers. CUB has addressed this issue before in its testimony.[7]

Oregon has a statute that specifies how the utilities' tax burden should be passed through to customers.[8] That law contains a specific reference to deferred taxes. Therefore, CUB believes that the Commission must look to SB 967 to determine the appropriate application of tax benefits associated with pension accounting, just as it looks to SB 967 for the appropriate way to determine the level of state and federal income taxes that customers are charged. As stated in CUB's Reply Testimony, CUB believes that SB 967 requires the deferred tax benefits associated with providing utility services be passed through to customers.

IV. Staff's recommendation to allow the prospective ppa/apl in rates going forward

Staff recommends that the companies be granted a return on the ppa/apl going forward, with the caveat that the return be more like that of a balancing account. CUB, for all the reasons argued in its Reply Testimony,[9] does not believe that the shareholders should be awarded this windfall – or in the case of Idaho Power, customers should not be awarded this windfall. If the return was more in line with that of a balancing account (lower than authorized ROE), this would mitigate some of CUB's concerns with the economic inefficiency of such a framework. However, if the companies are allowed dollar for dollar recovery on the ppa/apl, there is little leverage that the parties can exercise to incentivize prudent management of pension funds. In fact, in this docket, the

[7] UM 1633 CUB/100/Jenks-McGovern/31-32.
[8] *See* ORS 757.269.
[9] *See generally* UM 1633 CUB/100/Jenks-McGovern.

Joint Utilities have claimed that the large prepaid pension assets were a result of factors out of their control (the recession and the Pension Protection Act), absolving their shareholders of responsibility, for the years of accumulation. But the facts show that much of this was accumulated before the recession and PPA. In addition, PGE, wanted to be financially rewarded for the years when the pension fund performed admirably[10] as well as for the years where it performed poorly. CUB believes that the companies are not innocent bystanders to the accumulation of the ppa/apl and should not be treated as such.

While CUB is supportive of the continuation of FAS 87 for ratemaking purposes, it is also cognizant of the shortcomings of FAS 87, and does not intend for those to unfairly burden the companies. As CUB discussed in its Reply Testimony, FAS 87 expense is a component of accrual accounting, not equivalent to annual expense in cash accounting. Moreover, each year, the FAS 87 expense forecast, potentially included in rates, is merely a proxy for the actual FAS 87 expense. Because the estimate imputes many unknown and uncontrollable factors, short term accuracy is problematic. This can lead to short term annual discrepancies and regulatory lag. For this reason, CUB is open to a balancing account, which would true up forecasted FAS 87 with actual FAS 87 expense.

$$Balancing\ Account = \sum FAS87\ Expense_{actual} - FAS87\ Expense_{actual}$$

Note that this does not mix cash accounting with accrual accounting. Instead, it is consistently based solely on accrual accounting. CUB does not support a balancing account that mixes cash and accrual accounting, for example:

$$Balancing\ Account = \sum FAS87\ Expense_{forecasted} - Cash\ Contributions_{actual}$$

[10] UM 1633 CUB/110/Jenks-McGovern/1.

or

$$Balancing\ Account = \sum FAS87\ Expense_{actual} - Cash\ Contributions_{actual}$$

CUB believes this approach would allow the companies to be made whole in real time, while still treating ratepayers fairly.

V. Staff's recommendations for alternative treatment

Other recommendations made by Staff for alternative treatment involve considerations of competing claims by different parties and the various natures of balancing accounts, assets, costs, forecasts, accounting methods and other subtleties. However, all alternative treatments, proposed by Staff, which involve attempting to sort out the historic ppa/apl, are overly burdensome and unjust. CUB believes that dissecting decades of inconsistent ratemaking applications is an exercise that is neither efficient, nor productive. Even if the companies could produce the relevant information for appropriate prudence review, the justification for forcing current and future ratepayers to pay for decades old shareholder compensation is weak. Moreover, the precedent set by such an approach would be difficult to swallow.

Finally, CUB is concerned about Staff's acceptance of the idea that "actual cumulative FAS 87 expense will equal total cash outlays from the companies to their pension funds."[11] The Joint Utilities recognize that "[t]here is one major correlation between contributions and FAS 87 expense. That is, to the extent contributions are made by the Joint Utilities, those contributions act to reduce future FAS 87 expense,"[12] or in other words, drive FAS 87 more negative, and subsequently increase the prepaid pension

[11] UM 1633 Staff/100/Bahr/13, lines 8-10.
[12] UM 1633 Joint Utilities/100/Joint Parties/ 7-8.

asset. This would, as CUB demonstrated in its Reply Testimony, in fact prohibit the ppa/apl from being paid down.

Moreover, by the Joint Utilities' expert Mr. Kenneth Vogl's own admission, pension expense, not FAS 87 expense, in theory, over time should equal cash contributions.[13] But pension expense, includes FAS 88. This can be problematic, as we already see that in the answer to CUB's DR 5, special termination benefits are encapsulated in FAS 88. Towers Watson finds that "Half of all responding plan sponsors are looking to transfer some or all of their DB plan obligations," bringing into play FAS 88.[14]

Once one is open to the idea that the ppa/apl doesn't necessarily amortize down to zero or that cash accounting/accrual accounting equivalency requires the employment of FAS 88, the door is open to consider what the possibilities are for a prepaid pension asset that does not diminish. One such possibility is company request for recovery of the ppa, in addition to recovery on the ppa, as Mr. Vogl discussed before the NM Regulatory Commission.[15] As customers continue to pay a return on the prepaid pension asset, and that asset does not decline (it might even grow due to negative FAS 87), then at some point Oregon will be faced with the dilemma over what to do with the asset, itself. CUB believes that if the companies are awarded a return on the prepaid pension asset, then parties must at least consider the request for a return of the prepaid pension asset as a possible eventuality. Several decades ago, when the various companies asked to use pension expense as a basis for ratemaking, parties may have found it impossible to

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[13] UM 1633 Joint Utilities/200/Vogl/10.
[14] Towers Watson, *U.S. Pension Risk Management: What Comes Next?*, pg. 2. Retrieved from https://www.towerswatson.com/DownloadMedia.aspx?media=%7BDA30DAC4-1981-4FC9-AD92-F28FD532BAE5%7D.
[15] UM 1633 CUB/116/Jenks-McGovern/8-9.

imagine that, down the road, ratepayers would be asked to foot the bill for the return on the difference between pension expense and annual contributions. However, here we are considering that very issue. At this juncture, the parties may find it unfathomable that if the companies are granted return on the prepaid pension asset, that in a few years ratepayers will be on the hook for a return of the prepaid pension asset. The companies keep ensuring us that this will not happen, because the prepaid pension asset, over time, amortizes down to zero. However, we have seen no sound mathematical demonstration that this is the case.[16] We have, however, seen in New Mexico, a request for just such recovery, and we see that the prepaid pension asset can continue to grow, mathematically, through market returns that induce negative FAS 87.[17]

VI. Conclusion

In conclusion, CUB is hesitant to diverge from current ratemaking treatment without a persuasive argument that demonstrates improved fairness and accuracy in reporting. CUB is not arguing that ratemaking based on FAS 87 expense is the only fair recovery method, but it is the recovery method chosen over two decades ago by the companies and adhered to until the present. CUB believes that there is value in consistency and that as things stand, annual fluctuations in the cash/accrual accounting disparity disproportionately affect ratepayers and shareholders in different years. To pick and choose both the ratemaking treatment and the years in which to apply it amounts to cutting the cookie and choosing the (larger) half. This is implicitly unfair. Any ratemaking treatment going forward must treat both shareholders and ratepayers equitably. CUB's primary recommendation is to maintain the current ratemaking

[16] *See* UM 1633 CUB Exhibits 102-107.
[17] UM 1633 CUB/100/Jenks-McGovern/38-39.

treatment for pension recovery: that is, the continued use of FAS 87 as a basis for ratemaking. However, if this requires a balancing account, then CUB is open to a balancing account.

UM 1633 – CERTIFICATE OF SERVICE

I hereby certify that, on this 12th day of March, 2014, I served the foregoing **ALL-PARTY REBUTTAL 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 and five copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

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