BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1623

In the Matter of PORTLAND GENERAL ELECTRIC COMPANY, Application for Deferral Accounting of Excess Pension Costs and Carrying Costs on Cash Contributions	))))))))))

OPENING BRIEF

OF THE

CITIZENS' UTILITY BOARD OF OREGON

March 28, 2016

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I. Introduction

Pursuant to Administrative Law Judge ("ALJ") Grant's Procedural Conference Memorandum of October 22, 2015 and subsequent Ruling to extend the due dates of opening and reply briefs of March 18, 2018, the Citizens' Utility Board of Oregon ("CUB") submits its Opening Brief. In this brief, CUB addresses the appropriateness of Portland General Electric's ("PGE" or "the Company") request for deferral to track the amount equal to the net of pension expense designed in rates and actual Financial Account Standard ("FAS") 87 or pension expense.

The Company seeks recovery of the amount accrued between August 22, 2012 and December 31, 2013. In UE 215 (test year 2011), PGE's annual pension expense was set at approximately $5.1 million.[1] PGE's actual FAS 87 pension expense was $13.2 million in 2012 and $18.6 million in 2013.[2] Therefore, the amount subject to potential deferral in this docket is approximately $2.9 million for 2012 and $13.5 million for 2013.[3]

We address:

1. Whether the Company's request for deferral meets the statutory bases articulated in ORS 757.259(2)(e) for granting deferrals; and
2. Whether the Company's request meets the bar to be granted by the Commission on a discretionary basis;

The Commission uses a two-stage review to determine whether to grant a deferral application.[4] During the first stage, the Commission examines whether the application in question satisfies the statutory requirements in ORS 757.259(2)(e). Pursuant to ORS 757.259(2)(e), the Commission may authorize deferral of the following:

> Identifiable utility expenses or revenues, the recovery or refund of which the commission finds should be deferred in order to minimize the frequency of rate changes or the fluctuation of rate levels *or* to match appropriately the costs borne by and benefits received by ratepayers. (emphasis added).

Whether either standard is satisfied requires an examination of the facts presented on a case-by-case basis.[5] Here, PGE argues not only that its request matches the costs and benefits received by ratepayers, but also that it "could also minimize the frequency or

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[1] UM 1623 – Staff/100/Bahr/4, lines 3-4.
[2] *Id*. at lines 4-5.
[3] *Id*. at lines 7-8.
[4] *Id*. at p. 5, lines 12-13.
[5] *In re Public Utility Commission of Oregon*, Docket No. UM 1147, Order No. 05-170 at 5 (October 5, 2005).

fluctuations of rate changes."[6] CUB argues that PGE's request does not meet either part of the requirement in ORS 757.259(2)(e).

The second stage of the Commission's deferral application review concerns whether a request meets the bar to be granted on a discretionary basis.[7] In doing so, the Commission considers two factors: (i) the type of event giving rise to the deferral and (ii) the magnitude of the amount to be deferred.[8] According to Staff, if a deferral application is based on an event determined to be a stochastic risk, deferral is warranted only if the financial magnitude of the event is substantial.[9] If the event is determined to be a scenario risk, deferral is appropriate when the financial effect of the event is material.[10] The Company's testimony argues that its deferral application meets the threshold to be granted on a discretionary basis by the Commission.[11] However, CUB, in agreement with Staff, demonstrates why this is not the case and, subsequently, that the Company has failed to meet its burden of proof in this matter.

II. Discussion

A. Deferral Criteria Under ORS 757.259(2)(e)

According to the Commission in its investigation of deferred accounting, it:

[6] UM 1623 – PGE/200/Batzler-Hager/3, lines 11-13.
[7] UM 1623 – Staff/100/Bahr/5, line 20.
[8] *Id*. at lines 21-22.
[9] *Id*. at p. 5, lines 22-23; p. 6, line 1.
[10] *Id*. at p. 6, lines 2-3.
[11] UM 1623 – PGE/200/Batzler-Hager/5.

> [D]ecline[s] to adopt additional standards to determine whether an application meets the requirements of ORS 757.259(2)(e). . . . [S]ubsection (e) sets out a two-prong test, in which the proposed deferred account must either minimize the frequency or fluctuations of rate changes or match the costs and benefits received by ratepayers.[12]

PGE has not demonstrated that this deferral application will serve either of the exclusive legal criteria to warrant deferral under ORS 757.259(2)(e).

i. PGE's Deferral Application Does Not Minimize the Frequency of Rate Changes

PGE's deferral application fails to meet the first prong of the two-part test laid out in ORS 757.259(2)(e). From a simplistic perspective, this deferral application inherently fails to minimize the frequency of rate changes because, were the Commission to grant it, it would result in a rate change that would otherwise not occur.[13] Further, PGE has filed three general rate cases in three years.[14] With three rate cases in three years, and another rate change that would result if this unfounded deferral application is approved, PGE cannot make a valid claim that this application will minimize the frequency of rate changes. PGE argues that the alternative to filing this deferral applicationwould have been to file for interim rates in 2012 and 2013, which would have resulted in more frequent rate changes.[15] However, this argument is unavailing. Interim rates are an extraordinary tool that has rarely been used since the inception of the Commission's three Commissioner structure in 1986. That a different approach may have led to more frequent rate changes does not negate the fact that this deferral request would require an additional rate change upon amortization and, therefore, does not minimize rate changes.

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[12] *In re Public Utility Commission of Oregon*, Docket No. UM 1147, Order No. 05-170 at 5 (October 5, 2005).
[13] UM 1623 – Staff/100/Bahr/6, lines 15 – 17.
[14] UM 1623 – CUB/100/McGovern/12, lines 22 – 23.
[15] UM 1623 – PGE/200/Batzler-Hager, lines 10-11.

ii. PGE's Deferral Application Does Not Match the Costs and Benefits Received by Ratepayers

Similarly, PGE's deferral application fails to meet the second prong of ORS 757.259(2)(e). In its testimony, PGE fails to describe how its deferral application matches the costs and benefits received by *ratepayers*, as required in the statute. Instead of demonstrating how it meets this prong of the necessary test, PGE baldly asserts that its deferral application meets statutory requirements without any mention of the effect on ratepayers.[16] There, the Company claims to match benefits and costs through simply providing post-retirement benefits to its employees. PGE's argument is attenuated and tangential, and asserts that by providing a pension to its employees, its workforce is motivated and, therefore, "benefit[s] PGE's customers through the provision of safe, affordable, and reliable service."[17] The only ratepayer benefit discussed is supplying service—an act that it is required to furnish as a utility.

Instead of matching costs with benefits, granting PGE's deferral application would have an adverse effect compared to the status quo. The deferral application attempts to circumvent the long-standing pension recovery method delineated in FAS 87, which, as a method of accounting, is an actuarial method of matching the costs incurred in a particular year with the benefits accrued.[18] To use the FAS 87 method for ratemaking is explicitly to match the costs and benefits of the pension plan in rates.[19] Additionally, where smoothing is concerned, fluctuations in cash contributions and

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[16] UM 1623 – PGE/200/Batzler-Hager/3, lines 11-12.
[17] *Id*. at lines 19-20.
[18] *In re Public Utility Commission of Oregon*, Docket No. UM 1633, Order No. 15-226 at 2, (August 3, 2015); UM 1633 – Joint Testimony/200/Vogl/4; UM 1633 – CUB/100/Jenks-McGovern/30.
[19] UM 1623 – CUB/100/McGovern/13, lines 2-3.

attendant pension plan value can occur rapidly, but FAS 87 has a smoothing effect in rates.[20] Once again, Staff and CUB came to the same conclusion on this issue, as Staff noted that FAS 87 is used to smooth potentially substantial volatility in a utility's annual cash payments to its pension fund.[21] As a mechanism for matching benefits and costs, FAS 87 is superior to the deferral sought by PGE, and should be retained.

It should be noted that PGE's application defers FAS 87 costs, with interest, from 2012 and 2013, but does not specify when it will seek amortization of these costs. Therefore, the longer these costs are deferred without amortization, the greater the mismatch between the set of customers who are paying the cost and the set of customers on whose behalf the cost was incurred.

Because PGE's deferral application fails to either minimize the frequency of rate changes or match the costs and benefits received by ratepayers, it does not satisfy the statutory criteria for deferral under ORS 757.259(2)(e).

B. The Commission's Discretionary Criteria to Approve Deferral

PGE's deferral application fails to meet the threshold for discretionary approval by the Commission because the rise in PGE's pension expense—the event leading to this application—was a foreseeable, stochastic risk. Further, the amounts sought, and magnitude of harm incurred, by PGE is not substantial.

The Commission has set out a path to determine whether an event justifies the Commission's exercise of discretion to open a deferred account. The Commission looks first at whether the event is stochastic or scenario in nature. If stochastic, where the event

[20] *See generally In re Public Utility Commission of Oregon*, Docket No. UM 1633, Order No. 15-226, (August 3, 2015).
[21] UM 1623 – Staff/100/Bahr/6, lines 20-21.

was modeled or foreseen, then "the magnitude of harm must be substantial" in order to be eligible for deferred accounting.[22] If scenario, then the magnitude of harm would likely need to be lower.[23] Stochastic risks are not appropriate for deferred accounting, as long as the risks are reasonably predictable and quantifiable and have no substantial financial impact on the utility.[24]

According to the Commission, a stochastic risk can be predicted to occur as part of the normal course of events, whereas a scenario risk is not capable of being predicted or quantified. If an event was modeled in rates, the Commission then evaluates whether the event was within a foreseen range of risk, or whether extenuating circumstances were involved that rendered the event unforeseeable. If the event was not modeled in rates, the Commission assesses whether it was otherwise foreseeable in the normal course of business.[25] The Commission examines the triggering event that led to the deferral application, and, importantly, the utility bears the burden of identifying the event and showing its significance.[26]

i. The Increase in PGE's Pension Expense Represents a Stochastic, Foreseeable Risk

The increase in PGE's pension expense that gave rise to the current deferral application is a stochastic risk because it was forecasted in rates and occurred as a part of the normal course of events. Pension expense clearly falls into the category of stochastic

[22] *In re Public Utility Commission of Oregon*, Docket No. UM 1147, Order No. 05-170 at 8-9 (October 5, 2005).
[23] *Id*.
[24] *In re Portland General Electric Company*, Docket No. UM 1071, Order No. 04-108 at 8-9 (March 2, 2004).
[25] *In re Portland General Electric Company*, Docket No. UM 1234, Order No. 07-049 at 8-10 (February 12, 2007).
[26] OPUC Order No. 05-170 at 7.

risk as it is a normal cost that is forecasted in every rate case.[27] According to Staff, the possibility that the actual expense will be different than what is forecasted in rates is a foreseeable risk.[28]

The Company's FAS 87 expense is a stochastic, fluctuating risk that is modeled in rates. Therefore, whether deferral is warranted turns in part on whether the difference between actual expense and forecasted expense during the proposal deferral period was within a foreseen range of risk.[29] Here, the variance between PGE's actual FAS 87 expense and pension expense is within a foreseen range of risk because, over time, the Company's net pension expense naturally fluctuates between being over and under the amount forecasted in rates.[30] The risk that a return may be either higher or lower than anticipated is stochastic, and years in which a utility obtains a lower return should be offset by years in which the utility earns a higher return than anticipated.[31] Therefore, to warrant deferral, costs resulting from a stochastic risk must be such that a utility could not expect the costs to balance out over time.[32]

Here, that is not the case. PGE collected, in rates, $84 million in excess of actual pension expense in the period from 1997 – 2004.[33] Unsurprisingly, the Company did not file for a deferral at all during that time period.[34] Although there are certainly years when PGE under-recovers from its pension expense—such as those that led to this deferral

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[27] UM 1623 – CUB/100/McGovern/11, lines 27-28.
[28] UM 1623 – Staff/100Bahr/7, lines 6-8.
[29] UM 1623 – Staff/100/Bahr/7, lines 8-11.
[30] *See generally* UM 1623 – CUB/100/McGovern/8; UM 1623 – Staff/100/Bahr/8.
[31] UM 1623 – Staff/100/Bahr/12, lines 6 – 9.
[32] *Id*. at lines 9-11.
[33] UM 1623 – CUB/100/McGovern/7, lines 12 – 14.
[34] *Id*.

application—a historical perspective demonstrates that under-recovery and over-recovery balance out over time.[35]

The risk that the Company will under-recover from its pension expense is stochastic in nature, and the costs incurred in those years balance out in years where the Company over-recovers.

ii. The Amounts at Issue are Not of Sufficient Magnitude to Warrant Deferral

Since the deferral amounts requested in this matter result from a stochastic risk, the Company's threshold is raised. PGE must demonstrate that the deferral amounts requested are substantial, rather than merely material.[36] In Opening Testimony, CUB and Staff were in agreement that the deferral amounts requested in this application are not substantial.

An examination of the Company's financial statements and annual filings reveals that its 2012 revenuewas approximately $1.805 billion, and its net income was approximately $141 million.[37] The Company's 2013 revenue was $1.810 billion, and its net income was $105 million.[38] PGE's annual revenue requirement is approximately $1.8 billion.[39] The amount included in this deferral totals $16.5 million.[40] Therefore, the impact of this deferral is less than one half of one percent of the Company's annual revenue.[41] At issue is whether amounts less than one half of one percent of the

[35] *Id.* at p. 8, lines 17-18.
[36] UM 1623 – Staff/100/Bahr/12, lines 14-16.
[37] *Id*. at lines 20-21.
[38] *Id*. at p. 12, line 20; p. 13, line 1.
[39] UM 1623 – CUB/100/McGovern/10, lines 12-13.
[40] *Id*. at line 12.
[41] *Id*. at lines 13-14.

Company's annual revenue are considered "substantial" for purposes of a deferral request.

Although the Commission has declined to set a specific numerical criterion regarding what is substantial for the sake of determining approval of a deferral request, it has articulated negative and positive examples that provide a framework for analyzing the deferral application in this case.[42] In Order No. 04-108, the Commission noted:

> In UM 995, for instance, we established a deadband around PacifiCorp's baseline of 250 basis points of return on equity. We allowed no recovery of costs or refunds to customers within that deadband, reasoning that the band represented risks assumed, or rewards gained, in the course of the utility business. In the Idaho Power cases, discussed below, we allowed a partial recovery for a financial impact that represented approximately 700 basis points of Idaho Power's return on equity.[43]

In the docket in which Order No. 04-108 was issued, the Commission denied PGE's request for deferral of hydro replacement power costs, finding that the financial impact was not substantial.[44] There, PGE claimed that it incurred $31.6 million in expenses in excess net variable power costs ("NVPC"), only some of which were attributable to hydro replacement costs.[45] PGE asserted that this excess NVPC amounted to 172 basis points of return on equity.[46] The Commission, noting that 172 basis points of ROE was well short of the 250 basis points of ROE within which they allowed no recovery in UM 995, ordered that the financial impact was not substantial and that PGE's request was not "extraordinary enough to justify deferred accounting."[47]

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[42] *In re Portland General Electric Company*, Docket No. UM 1071, Order No. 04-108 at 9 (March 2, 2004).
[43] *Id*.
[44] *Id*. at 11.
[45] *Id*. at 2.
[46] *Id*.
[47] *Id*. at 9-11.

Here, Exhibit 101 of the Company's testimony indicates its adjusted ROE for 2012 and 2013 was 9.48 percent and 6.43 percent, respectively.[48] The Company's authorized ROE was 10 percent during this time.[49] CUB notes that the authorized ROE is not a guarantee, but a reasonable opportunity to earn the specified authorized ROE. CUB acknowledges that the Company earned below its authorized ROE, but not to a level that meets the discretionary standard of "substantial."

To show the effect of the deferral amounts in this matter on PGE's 2012 and 2013 ROE, Staff calculated that the amounts of $2.9 million for 2012 and $13.5 million for 2013 are equal to approximately 18 and 86 basis points of PGE's authorized ROE, respectively.[50] These basis point amounts are well within the 250 basis point range that the Commission has concluded represents a reasonable level of risk between rate cases.[51]

In Order No. 04-108, the Commission established, with concrete examples, that a utility should not be able to recover costs or refunds to customers within deadband of 250 basis points of return on equity. The Commission reasoned that such a financial impact did not rise to a level to be considered "substantial" for purposes of a deferral request. Because the amounts sought in the Company's deferral application in this matter fall well short of the 250 basis point threshold, the financial impact is not of sufficient magnitude to warrant deferral, and the Commission should deny its application.

[48] UM 1623 – Staff/100/Bahr/14, lines 21-22.
[49] UM 1623 – PGE/100/Batzler-Hager/6, line 14.
[50] UM 1623 – Staff/100/Bahr/15, lines 5-7.
[51] *Id*. at lines 7-9.

IV. Conclusion

For all of the reasons discussed above, CUB strongly believes that the Commission should deny PGE's application for deferral accounting of excess pension costs and carrying costs on cash contributions. First, PGE's deferral application fails to meet either of the statutory criteria enumerated in ORS 757.259(2)(e). It neither minimizes the frequency of rate changes, nor does it match the costs and benefits received by ratepayers. Beyond failing to meet these minimum statutory criteria, it does not meet the Commission's criteria to approve a deferral application on a discretionary basis. The consistently forecasted and inherently fluctuating nature of pension expenses renders their under-recovery a stochastic risk, and the amounts sought by PGE in this matter are not of sufficient magnitude to warrant deferral. CUB respectfully recommends that the Commission deny the Company's request for rate recovery.

Respectfully Submitted,

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