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March 28, 2016

Via Electronic Filing

Oregon Public Utility Commission
Attention: Filing Center
PO Box 1088
Salem OR 97308-1088

Re: UM 1623 – Application for Deferral Accounting of Excess Pension Costs and Carrying Costs on Cash Contributions

Attention Filing Center:

Enclosed for filing in the above-referenced docket is Portland General Electric Company's **OPENING BRIEF** to be electronically filed with the Oregon Public Utilities Commission.

Thank you in advance for your assistance.

Sincerely,

Douglas C. Tingey

DCT:jrb
Enclosures

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 PORTLAND GENERAL ELECTRIC COMPANY

I. INTRODUCTION

Pursuant to the procedural schedule set in this docket, Portland General Electric Company ("PGE") submits this Opening Brief. As demonstrated in PGE's application and testimony, the excess pension costs at issue were unforeseen, significant, and meet the requirements for deferral.

II. BACKGROUND

PGE filed its initial deferral application in this docket on August 22, 2012, seeking deferral of certain pension-related costs, specifically FAS 87 expenses in excess of those allowed in PGE's last rate case, and the carrying costs on cash contributions. At that time, several financial events occurred that resulted in these significant expenses, over which PGE had little, if any, control. As a result, PGE filed its application realizing that its pension costs were not likely to decline any time soon.

On November 15, 2012, the Commission opened docket UM 1633, a generic multi-utility examination of the treatment of pension costs in utility rates. At the suggestion of Staff and PGE, the Commission held this deferral docket in abeyance pending the outcome of UM 1633. PGE sought reauthorization of this deferral for one year periods beginning August 22, 2013, and August 22, 2014.

Docket UM 1633 proceeded, and a final order was issued on August 2, 2015. That order directed that utilities continue to use FAS 87 expense in ratemaking but declined to allow utilities to include the carrying costs on cash contributions. That order also recognized that PGE and Northwest Natural Gas Company had pending deferrals related to pension costs, and stated: "We direct the Administrative Hearings Division to activate these dockets and establish proceedings to determine the appropriate treatment of these applications in light of our decisions here." Order 15-226, p. 10, footnote 12. A prehearing conference was held in this docket on October 21, 2015, and a procedural schedule set. PGE represented at that prehearing that, consistent with the UM 1633 order, it would withdraw its request for carrying costs on cash contributions, which PGE did in its opening testimony in this docket. PGE/100/p. 5.

In its opening testimony, PGE also limited its request in this docket to costs incurred during calendar years 2012 and 2013. PGE explained that the amounts subject to deferral in 2014, and part-year 2015, were very close to offsetting. As a result, PGE has further narrowed its request to only amounts deferred from August 22, 2012, through December 31, 2013. Id. at 7. The excess FAS 87 pension expenses to be deferred are:

2012 (partial year):	$2.9 million
2013:	$13.5 million

Id at 3. As shown in PGE's application and testimony submitted in this docket, these amounts meet the requirements for deferral, and the Commission should approve their deferral.

III. LEGAL STANDARD

PGE requested deferral of excess FAS 87 pension expense under Oregon Revised Statutes §757.259. That statute states, in part:

> (2) Upon application of a utility or ratepayer or upon the commission's own motion and after public notice, opportunity for comment and a hearing if any party requests a hearing, the commission by order may authorize deferral of the following amounts for later incorporation in rates:
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> . . . .
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> (e) 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.

The Commission addressed this statute in Order 05-1070 and stated that an applicant may meet either of two tests: that the "proposed deferred account must either minimize the frequency or fluctuations of rate changes or match the costs and benefits received by ratepayers." Order 05-1070, p.5. PGE's application meets both of these criteria.

<u>Matching costs and benefits</u>. Part of PGE's market-based compensation to employees is post-retirement benefits. PGE's pension plan has long been part of its compensation package for employees, and no party has claimed that the pension plan is not prudent, or prudently managed. It is one part of a compensation package that helps PGE retain a knowledgeable, efficient workforce to provide electric service to customers. PGE/200/pp. 3-4. As discussed in greater detail below, regulatory and market forces beyond PGE's control caused FAS 87 pension expense during the deferral period (August 22, 2012 – December 31, 2013) to vary dramatically from the level assumed in rates. Customers received the benefits of service during the deferral period and this

deferral would match the costs with those benefits. Though other parties would like to make the issue more complex, it is not.

Staff incorrectly attempts to characterize FAS 87 expense. Staff claims that PGE's application does not match costs and benefits because: "FAS 87 expense, which is an accrual cost, is used as a proxy for the actual cash costs that fund a pension program. FAS 87 is used to smooth potentially substantial volatility in a utility's annual cash payments to its pension fund." Staff/100/p. 6. Staff appears to be claiming that FAS 87 expense is not an actual cost to the company. Such a claim is inconsistent with basic accounting principles, and also the Commission's recent order in docket UM 1633. As explained in the testimony: "PGE, like all large companies, operates on an accrual basis for accounting purposes. PGE has both incurred and accrued expenses and recognizes both types of expenses as actual expenses per Generally Accepted Accounting Principles (GAAP)." PGE/200/p. 16. The testimony further explains the basic accounting principles that demonstrate that FAS 87 pension expense is an expense like other pension expenses. Id. pp. 16-17. The Commission's recent UM 1633 order also reaffirmed the use of FAS 87 expense for ratemaking purposes.

<u>Minimize rate changes</u>. Staff's testimony also sets up an incorrect, and impossible to meet, reading of the deferral criteria regarding minimizing rate changes. Staff claims: "Because this deferral would result in a rate change that otherwise would not occur without the deferral, Staff concludes it does not minimize the frequency of rate changes." Staff/100/p. 6. Since all deferrals will potentially result in a rate change that otherwise would not occur, Staff's interpretation makes this statutory test one that could never be met. This cannot be a proper interpretation. In fact, the Commission's order in

docket UM 1147 addressed this test and stated: "[w]hether 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." Order 05-1070, p. 5. As PGE's testimony stated, PGE's alternative to this deferral request was to file for interim rate relief in 2012 and 2013, which would have caused additional rate changes and fluctuation. PGE/200/p. 4. In fact, the witness for Industrial Customers of Northwest Utilities (ICNU) attempts to criticize PGE for just that – saying the company could have filed subsequent rate cases rather than this deferral. ICNU/100/p. 2. PGE's deferral application meets the test of minimizing rate changes.

<u>Single Issue</u>. In their testimony the Citizens' Utility Board (CUB) and ICNU claim that PGE's deferral application constitutes improper single-issue ratemaking. That is not correct, ignores the specific purpose of the deferral statute, and is inconsistent with prior arguments by CUB and ICNU. ICNU testimony relies on ICNU's prior comments in this docket. ICNU/100/p. 3. Those comments cite several Commission decisions to support its argument, but not one of the cited orders was in a deferral docket. *Id*. By its nature, ORS 757.259 allows deferral of specific costs or revenues.

In prior dockets both CUB and ICNU have argued that deferrals should be limited to specific costs. In UM 1147, both CUB and ICNU argued that deferred amounts should be "extraordinary, unanticipated, and discrete". Order 05-1070, p. 11. In docket UM 1071, ICNU opposed PGE's deferral application in part because they claimed it was too broad, and not limited to a narrow set of costs. Yet here, they argue that a deferral that is limited to a narrow set of costs is improper. PGE's request is proper.

IV. FACTS AND ARGUMENT

In UM 1147, the Commission stated:

> The Commission will look to whether the event was modeled in rates, and, if so, whether extenuating circumstances were involved that were not foreseeable during the rate case, or whether the event fell within a foreseen range of risk when rates were last set. If the event was not modeled, we will consider whether it was foreseeable as happening in the normal course of events, or not likely to have been capable of forecast. The Commission will examine whether or not the "risks are reasonably predictable and quantifiable.
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> . . . .
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> 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.

Order 05-1070, p. 7.

The events that caused PGE's significant increase in pension expense were not foreseeable, and were in fact completely unforeseen by financial experts. Beginning in 2012, a combination of market returns on pension assets, legal requirements, and interest rates caused the increase in pension expense. The most significant of these triggering events was "an unexpected, significant, and continuing decline in the discount rate used to determine annual pension expense." PGE/200/p. 6. As PGE discussed in its testimony, a lower discount rate causes higher pension expense. *Id.* pp. 6-7. The actual discount rate in 2012 was 5%, which was 150 basis points lower than the discount rate used in the last general rate case, UE 215. The actual discount rate in 2013 was 4.24%, 226 basis points lower than the discount rate used in PGE's general rate case. *Id* at 7. This 226 basis point change in pension expense equates to an increase of approximately $18 million in pension expense, which is over five times PGE's final 2011 pension expense forecast submitted in UE 215. *Id.* The total percentage change in PGE's discount rate used for pension expense almost tripled when comparing the period 2010-2015 to the 1987-2009 period. *Id.*

Discount rates had never declined to the 2012 and 2013 levels in the history of FAS 87. *Id.* at 8. This unexpected decline caught industry experts by surprise. *Id.* at 10. During 2009 and into 2010, when PGE was developing its pension expense forecast for UE 215, long-term high quality bond yields (on which PGE bases its discount rate) remained very stable, between 6% and 7%. *Id.* at 9. At that time, economic forecasts from industry leaders such as Standard and Poor's and Global Insights forecast a rise in long-term corporate bond yields from 2010 to 2011. PGE/100/p. 10. The decline in the discount rates was so unexpected and had such a large effect on pension plans, that in 2012 the U.S. Congress included in the Moving Ahead for Progress in the 21st Century (MAP-21) Act provisions that worked to lower the required funding levels for pensions. PGE/200/p.10. While this Act, which has been extended several times since 2012, greatly reduced required cash contributions into pension plans, it did not address the dramatic increase to FAS 87 pension expense.

It is unreasonable to assume that PGE could have predicted such a steep decline in discount rates, leading to pension expense levels never before seen. To PGE's knowledge, no financial or economic industry expert forecast that such low interest rates would remain for as long as they have persisted. *Id.* at 12. Just the opposite, interest rates were consistently forecast to rise compared to 2009 levels. *Id.*

<u>Impact</u>. The impacts of these unprecedented events on PGE's pension expense were very significant, as noted below.

1. PGE's 2012 (full-year) net pension expense was $13.2 million, 160% above the $5.1 million included in retail prices in UE 215.[1] Prior to this year the highest annual net pension expense PGE had ever incurred was $5.4 million. *Id.* at 13.
2. PGE's 2013 net pension expense was $18.6 million, 265% above the amount included in retail prices. *Id.*
3. The excess pension expense that PGE is seeking recovery of for 2012 represents 2% of PGE's net income, and 13% of PGE's net income for 2013. *Id.* at 14.
4. Actual pension expense in 2012 was four standard deviations above the average expense between 1987 and 2010. For 2013, pension expense was five standard deviations above that mean. *Id*. at 20.
5. In part because of this increased pension expense, PGE's earnings were below its authorized level of 10%. In 2012, PGE's regulated adjusted ROE was 9.46%, and in 2013 it was 6.43%. PGE/100/p. 6.

Regardless of whether the standard for magnitude of these costs is 'substantial' or something less, these costs qualify for deferral.

Other parties argue that such events are foreseeable, or are part of normal variation in pension expense. No variation of this magnitude was modeled in rates. In fact, no variation at all was modeled in rates, although PGE and parties certainly expected minor variations in this and all other expenses. Parties claim that this is a stochastic risk, one capable of being modeled in rates. But, with pension expense, as with other

[1] PGE and other parties stipulated to a $5.1 million expense in UE 215 for test year 2011. This amount was based on the average of PGE's December 31, 2009 forecast indicating a total FAS 87 pension expense amount of $3.8 million for 2011 and $6.4 million for 2012.

expenses, a point estimate is used in ratemaking. To actually model in rates the potential for such variation, pension expense would need to be modeled stochastically – with assumptions that divergence from the point estimate could be as large as seen here (i.e., four-five standard deviations). Rates are not set that way, and it is hard to believe any party to this docket would support stochastic modeling that included a potential variation of the magnitude that occurred here. A variation of this size was simply not modeled in rates.

Parties have argued that in order for a deferral to be granted the harm must cause a change in ROE in excess of exceed 250 basis points. The parties point to power cost dockets for support. Such a test of magnitude has been discussed in power cost deferral contexts, but this is not a power cost deferral. Power costs include a group of costs including purchased power, fuel, transportation, and related costs. Power costs are usually between 40% and 50% of PGE's operating expenses. PGE/200/p. 15. This deferral is for a more limited cost category. Applying a 250 basis point threshold is not appropriate here. For 2013, it would have taken a decrease of $39 million to cause a 250 basis point change. *Id.* To meet such a test, pension expense would have needed to change by over 700%. *Id.* That is particularly inappropriate when PGE's earnings for 2013 were already 357 basis points below that authorized.

V. CONCLUSION

Due to equity market changes, legal requirements, and unforeseen significant changes in interest rates, in just over 16 months PGE incurred over $16 million in net pension expense above that included in the last rate case. At the same time, PGE's regulated earnings in 2013 fell to 6.43%. PGE's deferral application meets the criteria established by law and Commission decisions, and deferral should be granted.

DATED this 28th day of March, 2016.

Respectfully submitted,

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