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Portland General Electric Company
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December 2, 2015

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Oregon Public Utility Commission
Attention: Filing Center
201 High Street SE
PO Box 1088
Salem, OR 97308-1088

RE: **UM 1623 PGE Opening Testimony**

Attention: Filing Center

Enclosed for filing in the above captioned docket are an original and five copies of:

Opening Testimony of Portland General Electric Company:
- **PGE/100**

Also enclosed are an original and three copies of:
- **Exhibit 101**
- **Exhibit 102 (confidential)**
- **Work Papers**
- **Work Papers on CD (confidential)**

This document is being filed by electronic mail with the Filing Center.

Thank you in advance for your assistance. If you have any questions or require further information, please call Greg Batzler (503) 464-8644. Please direct all formal correspondence and requests to the following email address: pge.opuc.filings@pgn.com.

Sincerely,

Stefan Brown
Manager, Regulatory Affairs

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BEFORE THE PUBLIC UTILITY COMMISSION

OF THE STATE OF OREGON

UM 1623

Pension

PORTLAND GENERAL ELECTRIC COMPANY

Direct Testimony of

Greg Batzler
Patrick G. Hager

December 2, 2015

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I. Introduction

Q. Please state your names and positions with Portland General Electric ("PGE").

A. My name is Greg Batzler. I am a business analyst in the Regulatory Affairs department at PGE.

My name is Patrick G. Hager. I am the Manager of Regulatory Affairs at PGE.

Our qualifications are included at the end of this testimony.

Q. How did this docket come about?

A. On August 22, 2012, PGE filed an application requesting approval to defer for later rate making treatment certain costs associated with PGE's pension, specifically excess FAS 87 expenses and carrying costs on cash contributions. There were, however, similar policy issues to be addressed in both PGE's deferral request and Docket No. UM 1633, so that PGE believed the policy docket (UM 1633) should be resolved first. Consequently, PGE asked that no action be taken regarding our deferral application until the policy docket was resolved.

Q. What is the purpose of your testimony?

A. The purpose of our testimony is threefold. First, we describe UM 1623's procedural history to date. Second, we describe the changes from the original filing to our current request. Finally, we discuss the economic conditions and other events that led to PGE's decision to file the original August 22, 2012 deferral application and support the request in this docket.

Q. What are your conclusions?

A. PGE's pension recovery request is justified for three reasons.

1) PGE prudently incurred the requested pension expenses as a direct result of providing safe, affordable, and reliable electric service to our customers.

2) PGE could not reasonably predict or quantify the economic and other conditions that led to PGE's actual pension expense costs for 2012 and 2013 that greatly exceed the amounts set in rates, prior to their occurrence.
3) The level of financial impact to PGE, as a result of actions outside of its control, is of a significant nature.

As a result, we request that the Commission approve PGE's deferral request in this docket as outlined below.

II. Deferral Application History

Q. Please describe how PGE accounts for pension expense.

A. PGE records its pension expense based on Accounting Standards Codification (ASC) 715, "Compensation – Retirement Benefits," which prior to July 1, 2009, was known as Statement of Financial Accounting Standards No. 87 or "FAS 87." This accounting treatment requires that the cost of employee pension benefits reflect accruals that equal the present value of pension commitments to employees. Determining the amount of annual pension expense depends on a complicated interplay of forecasted items such as interest rates and market investment returns, along with prior history, which, in turn, affects future projected obligations and plan assets. PGE and other parties provided extensive detail on the components making up pension expense in testimony throughout the UM 1633 proceeding.

Q. What amount of pension expense did the Commission approve in UE 215 (test year 2011)?

A. PGE's final approved revenue requirement for UE 215 included $5.1 million for FAS 87 pension expense. PGE's next general rate case was UE 262, with a 2014 test year.

Q. What did PGE record as its actual pension expense in 2012 and 2013?

A. In 2012, PGE's actual net FAS 87 pension expense after capitalization was $13.2 million and in 2013, it was $18.6 million. These amounts are significantly higher than the amount included in PGE's rates for these years, with the amounts subject to the deferral totaling approximately $2.9 million for 2012[1] and $13.5 million for 2013 as shown in PGE Exhibit 101. While subsequent general rate cases have allowed PGE to update amounts

[1] The amount requested for 2012 is pro-rated based on the filing date of the original application.

collected for FAS 87 expense, the high level of expense that has persisted since 2012 is expected to continue for the foreseeable future.[2]

Q. Please describe the deferral application history.

A. On August 22, 2012, PGE filed an application requesting approval to defer for later rate-making treatment certain costs associated with PGE's pension, specifically excess FAS 87 expense and carrying costs on our cash contributions.

Table 1 below provides the dates of PGE's original filing and reauthorization applications:

Table 1

Application	Filing Date	Renewal Period
Original Filing	August 22, 2012	8-22-2012 / 8-21-2013
First Reauthorization	August 22, 2013	8-22-2013 / 8-21-2014
Second Reauthorization	August 22, 2014	8-22-2014 / 8-21-2015

The Commission opened a generic investigation docket (UM 1633) in order to address, from a policy standpoint, the treatment of pension expenses in Oregon utility rates. This docket was opened November 15, 2012, and PGE intervened on December 19, 2012.

Although PGE filed the original Application for Deferral of Excess Pension Costs and Carrying Costs on Cash Contributions before the opening of UM 1633, the Commission Staff (OPUC Staff or Staff) recommended "the Commission delay its investigation of PGE's application to defer pension expense and carrying costs while the generic investigation (UM 1633) moves forward."[3] Additionally, Staff stated that further investigation into this matter is warranted, but that UM 1633 is the proper forum to address the policy issues raised.

[2] PGE's net pension expense totaled approximately $16.0 million for 2014 and is expected to total approximately $17.2 million for 2015.
[3] October 31, 2012 comments on PGE's Application for UM 1623.

III. UM 1633 Decision

Q. Please briefly summarize the decision in UM 1633.

A. On August 3, 2015, the Commission issued Order No. 15-226, affirming the continued use of FAS 87-based recovery and rejecting the inclusion of the prepaid pension asset in rate base (and its associated deferred tax liability). As part of this order, the Commission directed the Administrative Hearings Division to activate UM 1623 and establish proceedings to determine the appropriate treatment of PGE's UM 1623 applications.

Q. How does the Commission's ruling in UM 1633 affect PGE's request in this docket?

A. Since the Commission rejected the inclusion of the prepaid pension asset in rate base, PGE requests to modify its application so as to remove the amounts in our request that relate to the prepaid pension asset. Thus, the request would now include only FAS 87 expenses above the amounts authorized in rates.

Q. Does PGE propose any other changes to its original request(s)?

A. Yes. PGE also requests to narrow the deferral period to only two years: 2012 (pro-rated based on the filing date of the original application) and the full calendar year 2013.

Q. Why is PGE proposing to narrow the deferral period?

A. PGE proposes this change because the variances (between the actual and forecasted levels of FAS 87 expense) for 2014 and 2015 are largely offsetting. PGE's actual 2014 net pension expense was approximately $3.5 million below the amount approved in UE 262, while PGE expects its actual 2015 net pension expense to be approximately $3.6 million above the amount approved in UE 283. Additionally, PGE's original request and subsequent reauthorizations cover periods that span three different general rate cases.[4] By narrowing

[4] Docket Nos. UE 215, UE 262, and UE 283.

the period to cover only 2012 and 2013, only one general rate case applies (UE 215, Order No. 10-478), reducing the complexity of this deferral application and subsequent amortization request.

Q. Are there any other changes that PGE is proposing?

A. Yes. PGE withdraws its request for balancing account treatment within these applications and recommends using an earnings test set to PGE's authorized return on equity (ROE) (10.0%) for the years of 2012 and 2013.

Q. Why is PGE proposing this change?

A. PGE bases this change largely on the outcome of Docket No. UE 262, in which, based on a stipulation between PGE, Staff, Industrial Customers of Northwest Utilities, and the Citizens Utility Board, PGE withdrew its request for balancing account treatment of future pension costs. Using an earnings test also conforms to ORS 757.259(5).

Q. What was PGE's regulated adjusted ROE for 2012 and 2013?

A. As seen in PGE Exhibit 101, PGE's regulated adjusted ROE for 2012 and 2013 was 9.48% and 6.43% respectively, compared to PGE's authorized ROE of 10% for both years.

Q. Do the amounts subject to the deferral request for 2012 and 2013 raise PGE's ROE above 10%?

A. No. PGE's actual ROE for 2012 and 2013 would remain below 10% for both years even after including the amounts subject to the deferral request in this proceeding.

Q. Please summarize PGE's current request in this docket.

A. PGE seeks authorization to record and defer pension expense (or FAS 87 expense) in excess of the test year amounts established in the UE 215 general rate case (2011 test year) for the period of August 22, 2012 (the date of PGE's initial UM 1623 application) through December 31, 2013.

IV. Support for PGE's Request

Q. What are the primary factors that led to PGE's dramatic increase in FAS 87 expense beginning in 2012?

A. Two reasons account for PGE's large and unpredictable increase in its pension expense:

1. After UE 215 (test year 2011), the discount rates used in calculating pension expense, determined through the averaging of interest rates from a basket of long-term high quality AA-rated bonds,[5] declined to historic lows.
2. Significantly lower actual, compared to expected, market performance in 2011 reduced PGE's pension assets far below expectations.

Q. Please explain what effect a decline in the discount rate has on pension expense.

A. All else equal, reducing PGE's UE 215 forecasted discount rate (6.5%) by 25 basis points would result in an increase of approximately $1.4 million in pension expense. The impact of a given decrease in the discount rate will have a greater effect on pension expense if the initial forecasted discount rate is lower. For example, a 25 basis point reduction to a discount rate of 4.5% would result in an increase of approximately $2 million in pension expense.

Q. Please explain the events in 2012.

A. Rapid and unexpected declines to interest rates resulted in significant reductions to PGE's discount rate from the UE 215 level of 6.5% to actual discount rates of 5.0% for 2012 and 4.24% for 2013. We note that these historically low discount rates have continued into 2014

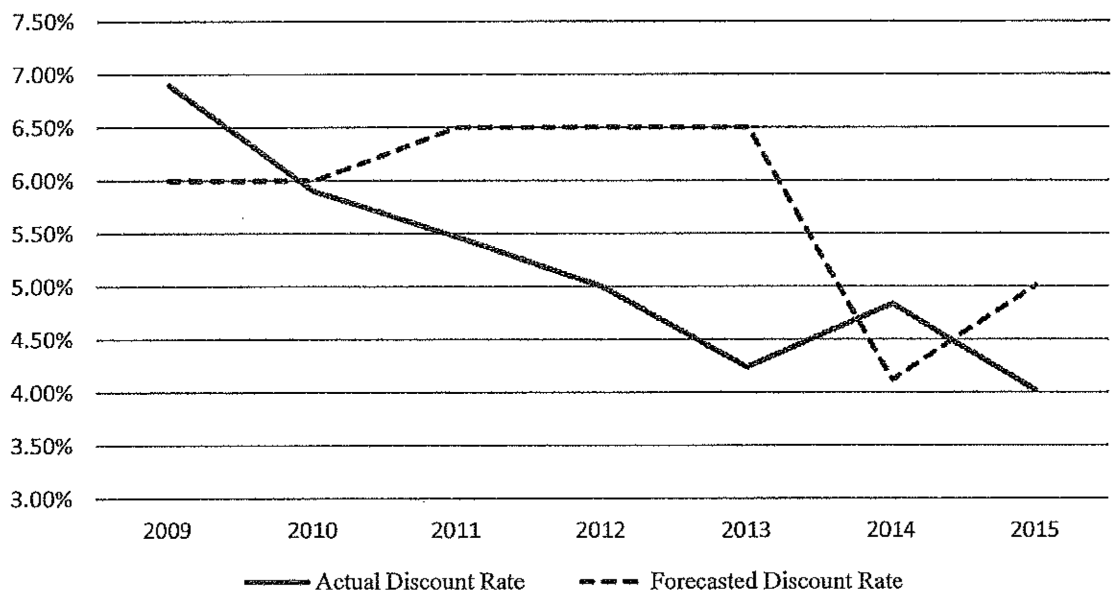
[5] This methodology is determined in accordance with Generally Accepted Accounting Principles (GAAP).

and 2015, with discount rates at 4.84% and 4.02%. A history of the annual discount rate PGE has used for FAS 87 expense since its inception[6] is included in our work papers.

Chart 1 below illustrates the rapid decline in PGE's forecasted and actual discount rate for the years of 2009 through 2015:

Chart 1

Discount Rate Used to Determine FAS 87 Expense



Q. Please describe the process PGE uses to set its annual discount rate for FAS 87 pension expense.

A. PGE determines its annual discount rate used for pension expense based on an index of high-quality corporate bonds that are selected in accordance with GAAP.[7] PGE's third-party actuarial consultants determine this discount rate at the beginning of the year and PGE uses it to set both its annual expense for the calendar year as well as the year-end

[6] The Financial Accounting Standards Board issued FAS 87 in December 1985, with an effective date for fiscal years beginning after December 15, 1986.
[7] The weighted average maturity of the bonds selected in determining PGE's discount rate for its 2015 pension expense was 21.4 years.

pension plan liabilities for the preceding year. For example, PGE calculated the 5.9% discount rate it used for 2010's pension expense and 2009's year-end pension plan liabilities in January 2010.

Q. Is this the same process PGE used to develop its 2011 <u>test year</u> forecast of pension expense?

A. No. When forecasting expenses for a general rate case, PGE generally needs to finalize forecasted expenditures over a year in advance of the test year in order to have time to analyze changes and prepare testimony and exhibits for filing. When forecasting the 6.5% discount rate used to set its forecasted expense for 2011, PGE considered a preliminary estimate for 2010's discount rate and any relevant financial market forecast data available at the end of 2009.

Q. What did the economic forecast data indicate in late 2009 and early 2010?

A. According to the economic forecast data available at the time from industry leaders like Global Insights and Standard & Poor's, long-term corporate bond yields were forecast to rise from 2010 to 2011. For example, according to the 2010 Economic Outlook from S&P,[8] 'AAA' corporate bond yields were forecast to rise by 120 basis points from 2010 to 2011,[9] increasing from [redacted] to [redacted]. Using this and other similar information, coupled with PGE's preliminary discount rate for 2010 pension expense, PGE forecast a rise in its discount rate from 2010 to 2011.

[8] Included in PGE's confidential work papers for Exhibit 1100 of UE 215 and here as Confidential PGE Exhibit 102.
[9] Page 6 of S&P's December 8, 2009 U.S. Economic Forecast.

Q. Did discount rates change significantly between PGE setting its forecast in late 2009 and filing UE 215 in February 2010?

A. No. High quality corporate bond yields, similar to the selected bonds PGE uses for setting its discount rate, remained high, as evidenced by the monthly average spot rate of 6.44% for bonds with a maturity between 15 and 30 years during February 2010.[10] Consequently, we did not revise our estimated discount rate used for the 2011 test year.

Q. Could PGE have forecast the dramatic decline in discount rates?

A. No. While at the time of the UE 215 filing and subsequent commission order, the Target Federal Funds Rate was at 0.25%,[11] long-term high quality bond rates remained relatively stable. In fact, from January 2010 through December 2010, the average monthly spot rate for high quality corporate bonds with a maturity between 15 to 30 years was 6.03%, according to the U.S. Department of the Treasury.[12]

Q. Had PGE ever experienced pension discount rates this low?

A. No. The lowest discount rate PGE had ever used for pension expense, prior to 2011, was 5.75% from 2005 through 2007 and the average discount rate PGE used for its pension expense from 1987 through 2010 was 7.3%. There was no history to suggest that rates could drop as low as they did.

Q. Is the magnitude of PGE's discount rate reduction from 2010 forward normal?

A. No. Moving from a 6.5% discount rate to discount rates below 5% is not normal variability. Prior to 2010, discount rates tended to move more bi-directionally, with an average annual

[10] According to information obtained from the U.S. Department of the Treasury. <http://www.treasury.gov/resource-center/economic-policy/corp-bond-yield/Pages/Corp-Yield-Bond-Curve-Papers.aspx>.

[11] The Fed lower reduced the Target Federal Funds Rate to this level on December 16, 2008, in response to the Great Recession

[12] http://www.treasury.gov/resource-center/economic-policy/corp-bond-yield/Pages/Corp-Yield-Bond-Curve-Papers.aspx.

change of less than -0.1% and a total change of -1.1% from 1987 through 2009. Since 2010, the average annual change has been approximately -0.5% and the total change has been approximately -2.9%. This magnitude of change in financial market conditions was not something that was susceptible to prediction.

Q. Please describe PGE's market performance of its pension assets leading up to the deferral request.

A. While PGE's market performance has consistently been above average,[13] PGE's return on pension assets for 2011 was 3.5%, which was significantly below the expected rate of return of 8.5%. In dollar terms, market underperformance resulted in an additional unfunded pension liability of $28.8 million in 2012. While annual returns rebounded in 2012, the lower than expected returns in 2011 reduced PGE's asset base and created a "ripple effect," lowering overall returns in subsequent years.

Q. How do lower than expected returns affect future FAS 87 expense levels?

A. There are two primary ways lower than expected returns on assets affect future FAS 87 expense.

1. When plan assets underperform relative to expectations, the difference is amortized through future FAS 87 expense, increasing the level of FAS 87 expense recognized in future periods.[14]
2. Lower than expected returns reduce PGE's asset base below expectations, reducing the total value of future returns, thus raising the level of FAS 87 expense.

[13] PGE's returns have been in the top 12% of returns experienced by similar plans over the past five years ending March 31, 2015.

[14] Net gains and losses in excess of 10% of the greater of projected benefit obligation or the market-related value of (pension plan) assets are amortized on a straight-line basis over the average expected remaining service of active participants expected to benefit under the plan, which for 2012 was 10.8 years.

V. Summary and Qualifications

Q. Please summarize your testimony including PGE's request in this docket.

A. Severe negative economic and financial conditions resulting from the Great Recession led to significant cost increases for PGE's pension plan. The magnitude of change in the financial market conditions that led to PGE's significant under-recovery of pension costs was not predictable. This led PGE to file its original application and subsequent reauthorization applications requesting approval to defer for later rate making treatment certain costs associated with PGE's pension plan. As such, based on PGE's original application(s) along with the revisions and support for our request contained herein, we request that, pursuant to ORS 757.259(2)(e), the Commission approve PGE's application to defer the difference between actual costs and the amounts included in general rates for FAS 87 expense covering the period of August 22, 2012 through December 31, 2013.

Q. Mr. Batzler, please state your educational background and experience.

A. I received a Bachelor of Arts degree in Radio and Television from San Francisco State University in 1997 and a Master of Business Administration degree from Marylhurst University in 2011. I have been employed at PGE since 2006, working in various departments including Meter Reading and Human Resources. I have worked in the Rates and Regulatory Affairs department since 2012.

Q. Mr. Hager, please state your educational background and experience.

A. I received a Bachelor of Science degree in Economics from Santa Clara University in 1975 and a Master of Arts degree in Economics from the University of California at Davis in 1978. In 1995, I passed the examination for the Certified Rate of Return Analyst (CRRA). In 2000, I obtained the Chartered Financial Analyst (CFA) designation.

I have taught several introductory and intermediate classes in economics at the University of California at Davis and at California State University Sacramento. In addition, I taught intermediate finance classes at Portland State University. Between 1996 and 2004, I served on the Board of Directors for the Society of Utility and Regulatory Financial Analysts. Locally, I have been on the Board of Directors for Advantis Credit Union since 2007, serving previously on the Audit Committee.

I have been employed at PGE since 1984, beginning as a business analyst. I have worked in a variety of positions at PGE since 1984, including power supply. My current position is Manager, Regulatory Affairs.

Q. Does this conclude your testimony?

A. Yes.

List of Exhibits

PGE Exhibit	Description
101	PGE Pension Recovery for 2012-2013
102C	Standard & Poor's 2010 U.S. Economic Forecast

PGE Pension Recovery for 2012-2013

(millions)	2012*	2013
A. Expense	20.6	31.1
B. Expense (net)	13.6	18.6
C. Regulatory recovery of FAS 87	5.1	5.1
D. Unrecovered FAS 87 (B-C)	3.0	13.5
Regulated Adjusted ROE	9.48%	6.43%

*Unrecovered FAS 87 for 2012 is pro-rated to account for PGE's original filing date of 8/22/2012

Exhibit 102C

Confidential