Portland General Electric Company
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February 12, 2016

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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 Rebuttal Testimony**

Attention: Filing Center

Enclosed for filing in the above captioned docket are:

Rebuttal Testimony of Portland General Electric Company:
- **PGE/200 (Redacted)**

Also enclosed are:
- **Exhibit 201**
- **Exhibit 202**
- **Exhibit 203**
- **Work Papers (electronically sent to puc.workpapers@state.or.us)**

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

Table of Contents

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 in our previous testimony, PGE Exhibit 100.

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 August 22, 2012 (the date of PGE's initial UM 1623 application) through December 31, 2013.

Q. What is the purpose of your testimony?

A. The purpose of our testimony is threefold. First, we demonstrate that PGE's deferral request meets the statutory requirements and Commission guidelines established in Order No. 05-1070. Second, we demonstrate that Staff's[1] analysis is incomplete and that their criteria are flawed. Finally, we identify inconsistences with and provide specific responses to other parties' testimony.

Q. What are your conclusions?

A. We find that: PGE's pension recovery request meets the statutory criteria and Commission guidelines established in Order No. 05-1070; and that other parties' arguments are flawed.

As a result, we believe that the Commission should approve PGE's deferral request in this docket.

[1] "Staff" refers to the Staff of the Public Utility Commission of Oregon.

Q. How is the remainder of your testimony organized?

A. In Section II, we describe how PGE's deferral request meets the statutory requirements of ORS 757.259. Section III details and provides support for how PGE's request meets the Commission's guidelines for deferrals. Section IV summarizes Staff's position, and then explains how Staff's criteria are incomplete and their analysis of PGE's request is flawed. Finally, Section V summarizes and addresses the issues with both the Industrial Customers of Northwest Utilities' (ICNU) and the Citizens' Utility Board of Oregon's (CUB) analyses and why the Commission should disregard them.

II. PGE's Request Meets Statutory Requirements

Q. What issue do parties raise with respect to the statutory requirement regarding your deferral request?

A. Both Staff (Staff Exhibit 100, page 6) and CUB (CUB Exhibit 100, pages 12-13) conclude that PGE fails to meet the requirement of ORS 757.259(2)(e).

Q. What is the statutory requirement set forth in ORS 757.259(2)(e)?

A. In Order No. 05-1070, the Public Utility Commission of Oregon (OPUC) specifies that ORS 757.259(2)(e) establishes two tests: the "proposed deferred account must *either* minimize the frequency or fluctuations of rate changes *or* match the costs and benefits received by ratepayers"[2] [emphasis added].

Q. Does PGE's request meet either part of this requirement?

A. Yes. PGE's request meets the second part of the requirement because the request seeks to match costs and benefits. Additionally, our request could also minimize the frequency or fluctuations of rate changes.

Q. How does PGE's request match costs and benefits?

A. PGE incurs annual pension expense as the direct result of providing market-based, competitive post-retirement benefits to employees. PGE's pension plan serves as an important retention tool that aids in keeping a highly skilled, experienced workforce at PGE. Through this and other pieces of PGE's total compensation package, PGE is better able to attract, retain, engage, and motivate a highly competent and efficient workforce, who benefit PGE's customers through the provision of safe, affordable, and reliable service.

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[2] Commission Order No. 05-1070, page 5.

Q. Has any party claimed that PGE's pension plan is imprudent?

A. No.

Q. If PGE's pension plan is a prudent and significant component of PGE's total compensation program and the costs requested for deferral in this proceeding are the direct result of PGE providing this plan to employees, doesn't this imply that the costs and benefits received by customers are matched?

A. Yes.

Q. How might have PGE's deferral request minimized the frequency or fluctuations of rate changes?

A. The alternative to filing our deferral request was to file for interim rates in 2012 and 2013, which would have resulted in more frequent rate changes.

Q. Is it necessary that PGE meet both parts of the statutory requirement?

A. No. It is only necessary to meet one part of the test.

III. PGE's Request Meets Commission Guidelines

Q. What issues do parties raise with respect to the Commission's guidelines in evaluating PGE's deferral application?

A. Staff argues that the events leading to PGE's request were foreseeable (Staff Exhibit 100, page 7) and therefore PGE's request fails to reach the magnitude sufficient to warrant approval (Staff Exhibit 100, pages 12-15). CUB mentions that the rise in PGE's pension expense was foreseeable (CUB Exhibit 100, pages 15-16) and that the amounts are immaterial (CUB Exhibit 100, pages 10-12). ICNU does not consider these guidelines.

Q. What are the guidelines established by the Commission?

A. The Commission established the following guidelines for approving or denying deferrals in Order No. 05-1070 of Docket No. UM 1147 (Investigation Related to Deferred Accounting):

> First, the Commission will examine the triggering event that led to the deferral application. The utility bears the burden of identifying the event and showing its significance. 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.' *See* Order No. 04-108 at 9. (Commission Order No. 05-1070, page 7)

The Commission continues by describing their approach to determining how the above affects the amount of harm that must be established by a utility:

> The next step is to examine the magnitude of the underlying event in terms of the potential harm. The type of event—modeled in rates or not, foreseeable or not—will affect the amount of harm that must be shown by the utility. 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. (Commission Order No. 05-1070, page 7)

Q. Are there additional Commission orders that might help identify the magnitude of harm that must be shown for risks that are unforeseeable?

A. Yes, in Commission Order No. 04-108, the Commission states that "to qualify for deferred accounting, the financial impact on the utility need be only material (for) events that fall outside the predictable and quantifiable" (Commission Order No. 04-108, page 9).

Q. Based on these Commission guidelines, what must PGE demonstrate in order to justify its request for deferred accounting?

A. We believe there are four specific items that PGE must demonstrate:

1. The event that caused PGE to file its deferral application was significant.
2. Though modeled in rates, there were significant extenuating circumstances that were not foreseeable during UE 215 (the previous general rate case).
3. The events leading to PGE's deferral request were neither reasonably predictable nor quantifiable.
4. The magnitude of PGE's increased pension expense compared to that in rates was substantial enough to warrant the Commission's exercise of discretion in authorizing deferred accounting treatment.

The remainder of this section demonstrates that PGE's request meets these conditions.

A. Significant Triggering Event

Q. Please describe the triggering event, which led to PGE's dramatic increase of pension expense.

A. The primary triggering event leading to the abnormally large increase in PGE's pension expense was an unexpected, significant, and continuing decline in the discount rate used to determine annual pension expense. As we discuss in our previous testimony, a decline in the discount rate leads to an increase in pension expense. An abnormally large decrease in the discount rate would lead to a large increase in pension expense.

Q. How significant was the decline in the discount rate?

A. PGE's actual discount rate of 5.00% in 2012 was 150 basis points below the discount rate used to set prices in UE 215 and the actual discount rate of 4.24% in 2013 was 226 basis points below the discount rate used to set prices in UE 215. A change of 226 basis points represents a gross change in pension expense of approximately $18 million,[3] or over twice PGE's $8.2 million actual gross[4] pension expense for 2011[5] and over five times PGE's final 2011 pension expense forecast submitted in UE 215.[6] As we discussed in PGE Exhibit 100 and illustrated below in Figure 1, the average annual change in PGE's discount rate has increased five-fold during the period 2010-2015 compared to the 1987-2009 period, and the total percent change in the discount rate between these two periods has almost tripled. This magnitude, by any definition, is of a significant nature and unexpected.

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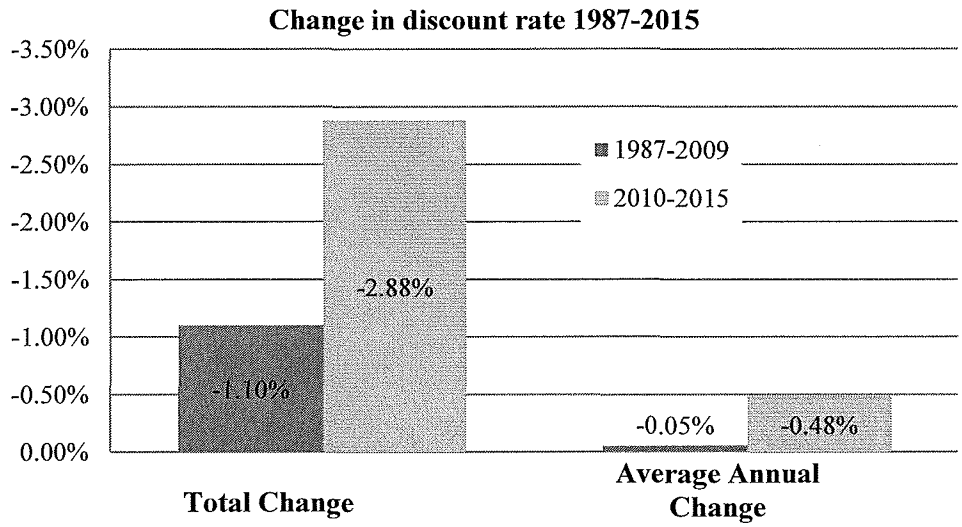
[3] $18 million equals 225 basis points multiplied by an increase of approximately $2 million per each 25 point change, as described in PGE Exhibit 100, page 8.

[4] Gross pension expense is the total amount before allocation between capital and operations and maintenance.

[5] PGE's gross pension expense for 2011 was $8.2 million compared with $31.1 million for 2013.

[6] PGE's final forecast for 2011 pension expense submitted in PGE's response to OPUC Data Request No. 237, Attachment 237-A for UE 215 (included here as PGE Exhibit 201), was $3.8 million.

Figure 1



B. Unforeseeable and Extenuating Circumstances

Q. In the history of FAS 87 pension expense, had discount rates ever declined to the level(s) they did in 2012 and 2013?

A. No. The discount rates used for FAS 87 pension expense had never approached the levels reached in 2012 and 2013. Prior to 2011, the lowest discount rate PGE had used was 5.75% in 2007. In comparison, the average discount rate PGE used for its pension expense from 1987 through 2010 was 7.3%.

Q. Please describe how PGE determines the annual discount rate used for pension expense.

A. PGE determines its annual discount rate through the averaging of interest rates from a basket of long-term, high quality, AA-rated bonds matched to the duration of the plan's cash flows. To perform this complicated calculation, PGE relies on qualified actuarial consultants. We have provided detail regarding the process in our work papers for PGE Exhibit 100. This forecast occurs in January of each budget year. Thus, PGE's expected discount rate for 2015 would be calculated in January 2015.

Q. How does this method compare to that used for determining the discount rate in a general rate case?

A. For establishing prices in a general rate case, PGE needs to finalize its forecasted expenditures approximately one year in advance of the test year in order to allow time for the 10-month regulatory process. As such, PGE must estimate the pension discount rate over a year in advance of its actual determination, by relying on actuarial and financial expert forecast information regarding bond markets, general financial market conditions, and preliminary estimates that are available a year prior to the test year. Consequently, for the 2011 test year, PGE would have prepared and finalized its forecast in late 2009 and early 2010.

Q. At the time PGE was working with its actuarial consultants to develop its pension expense amount for 2010, what were the market conditions for long-term bond yields?

A. In late 2009, when both the 2010 and 2011 pension estimates were being developed, long-term high quality bond yields had remained very stable over the year, averaging between 6% and 7%. In fact, the average spot rate on bonds with a maturity date between 15 to 30 years during January 2009 to November 2009 was 6.69%. Simply put, the bond market looked healthy when PGE prepared its 2011 test year forecast. This detail can be found in our non-confidential work papers for PGE Exhibit 100.

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 (S&P), long-term corporate bond yields were forecast to rise from 2010 to 2011. For example, according to the 2010 Economic Outlook from S&P,[7] 'AAA' corporate bond yields were forecast to rise by 120 basis points from 2010 to 2011,[8] increasing from [redacted] to [redacted] Furthermore, S&P's 2010 Economic Outlook forecast an additional rise of 90 basis points for 2012, or [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 5.90% for 2010 to 6.50% for 2011.

Q. Is it reasonable to assume that PGE could have foreseen the sudden decline in the bond market, which led to historically low discount rates and historically high pension expense for an extended period of time?

A. No. The large and unexpected decline in long-term high quality bond yields caught industry experts by surprise. This event had such a large effect on pension plans that it led, in part, to Congress enacting the Moving Ahead for Progress in the 21st Century (MAP-21) Act,[9] which included a package of pension provisions. In particular, the pension funding stabilization provision was included in direct response to the excessively low discount rates beginning in 2012. Disclosures in the bill related to the pension funding stabilization provision read in part, "as a result of the MAP-21, the plan sponsor may contribute less money to the plan when interest rates are at historical lows" (H.R. 4348, page 444). As discount rates have remained at historic lows, MAP-21 has been extended several times since 2012.[10]

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[7] Included in PGE's confidential work papers for Exhibit 1100 of UE 215 and as Confidential PGE Exhibit 102.
[8] Page 6 of S&P's December 8, 2009 U.S. Economic Forecast.
[9] H.R. 4348, the MAP-21 Act, signed into law on July 6, 2012.
[10] The pension funding stabilization provision was extended for 2014, 2015, and 2016 as part of the Highway and Transportation Funding Act of 2014 (HATFA) and the Bipartisan Budget Act of 2015 (BBA).

Q. Was PGE's final 2011 pension estimate used to set prices for UE 215?

A. No. PGE stipulated with Staff and Intervenors that pension expense would be reduced by approximately $700,000 from PGE's filed forecast and set at the average of amounts forecast for 2011 and 2012, based on an updated forecast as of December 31, 2009.[11]

Q. Did PGE believe its general rate case forecast for pension expense to be reasonably accurate?

A. Yes, but only within a range of confidence because such forecasts by their nature contain uncertainty. What makes 2012 and 2013 different with regard to PGE's pension expense is the degree to which actuals varied from the amount set in rates. Actuals were over three times higher than forecast and were outside the range of uncertainty that is normally expected in a forecast. To put the degree of change in perspective, pension expense for 2012 was over two standard deviations above the amount set in prices and approximately four standard deviations above PGE's average expense from 1987-2010. Pension expense for 2013 was over four standard deviations above the amount set in prices and approximately five standard deviations above PGE's average expense from 1987-2010.

C. Events That Led to PGE's Request were Unpredictable and Unquantifiable

Q. Could PGE have predicted the huge decline in long-term bond rates that led to the dramatic decline in discount rates?

A. No. As we discussed in the previous section, every forecast (by leading experts) of macro-economic and financial conditions, which include the forecasts of long-term, high-quality bond rates, projected healthy year-over-year growth for 2010-2011 and beyond.

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[11] Originally provided in UE 215 as PGE's response to OPUC Data Request No. 237, Attachment A, and provided here as Exhibit 201.

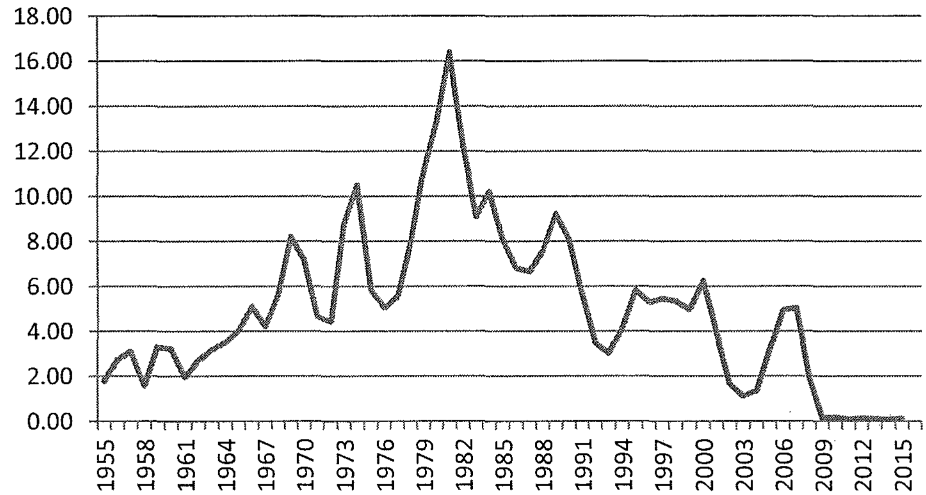
Q. How did interest rates behave during the Great Recession?

A. The Great Recession was the most severe economic downturn and longest persisting recession since the Great Depression. By 2009, the Target Federal Funds rate had already reached its lowest point in history,[12] but prior experience could not suggest it would remain at historic lows for seven years. Since the establishment of the Federal funds rate in the 1950s, its movement has generally coincided with overall economic conditions, but the Federal funds rate had never reached the range of 0.0% to 0.25%. When developing a forecast in late 2009 through early 2010, it would have been unreasonable for PGE to assume that the Federal funds rate would remain at effectively a 0.0% rate for seven years and have the kind of residual effect that it has had on long-term, high-quality bond rates. As we noted above, not one of the leading industry experts forecasted a continuation of such low interest rates. In fact, they consistently forecasted rising interest rates. Thus, it seems unreasonable to suggest that PGE should have built something to the contrary in our pension forecast. Figure 2 below provides Federal Funds Rates from 1955 through 2014.

[12] On December 16, 2008, The Federal Open Market Committee (FOMC or Fed) cut the federal funds target rate 75 to 100 basis points, creating an unprecedented range of 0.0% to 0.25%.

Figure 2

Federal Funds Rate



D. The Magnitude of PGE's Request is Material

Q. What standard must PGE meet regarding the magnitude of its request?

A. As PGE meets the first three Commission guidelines, PGE is required to demonstrate that the magnitude of our deferral request is material.

Q. Please describe how the increase to PGE's pension expense is material.

A. Prior to 2012, the highest net pension expense PGE had ever incurred for one year was approximately $5.4 million (in 2011) with $5.1 million included in PGE's retail prices.[13] This means PGE's full-year actual net pension expense for 2012 of $13.2 million reflects an increase of approximately 125% over 2011's actual expense and an increase of approximately 160% over the amount in retail prices. For 2013, PGE's full-year actual net pension expense of $18.6 million reflects a total increase of approximately 220% over 2011's actual amount and a total increase of approximately 265% over the amount set in prices.

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[13] 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.

Q. Did the increase in pension expense in 2012 and 2013 have an impact on PGE's earnings?

A. Yes. As stated in PGE's 2012 SEC Form 10-K, page 46: "increased pension expense contributed to the decrease in net income." PGE's 2013 SEC Form 10-K states: "higher pension costs . . . contributed to the decrease in net income" (page 48).

Q. What percent of 2012 and 2013 earnings are the amounts that PGE is requesting to be deferred?

A. The requested amount for 2012 represents approximately 2% of PGE's 2012 net income,[14] while the requested amount for 2013 represents approximately 13% of PGE's 2013 net income.[15]

Q. If the Commission finds that PGE does not meet the first three Commission guidelines, what level of magnitude must PGE meet?

A. According to Commission Order No. 05-1070, "(i)f the event was modeled or foreseen, without extenuating circumstances, the magnitude of harm must be substantial" (page 7).

Q. Has the Commission previously attempted to define "substantial" harm?

A. Yes, in Order No. 04-108, (Docket No. UM 1070, PGE's request for the deferral of replacement power costs), the Commission describes "substantial" as equating to more than 250 basis points of return on equity (ROE) (page 9).

Q. Has the Commission ever discussed the 250 basis point cap in any orders outside the context of power costs?

A. No, not that PGE is aware.

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[14] $2.9 million requested expenses/$141 million net income

[15] $13.5 million requested expenses/$104 million net income

Q. What portion of a utility's costs do power costs generally comprise?

A. While it varies by year, power costs are by far the largest cost to PGE, generally comprising 40% to 50% of operating expenses. In 2013, for example, PGE's power costs amounted to approximately 43% of operating expenses and taxes.

Q. What amount of dollars represents 250 basis points?

A. For 2013, the amount of dollars needed to affect a 250 basis point change to PGE's regulated adjusted ROE is approximately $39 million, which represents an approximate change of 6% above PGE's NVPC set in retail prices for 2013.

Q. What percent change would this amount represent compared to PGE's FAS 87 expense forecast?

A. A change of $39 million over PGE's FAS 87 expense set in retail prices for 2013 would represent a change of over 700%.

IV. PGE's Issues with Staff's Criteria

Q. What criteria does Staff use to determine if PGE's deferral request is warranted?

A. Although they do not specifically cite Commission Order No. 05-1070, the criteria Staff uses are similar to those the Commission describes in UM 1147. Staff begins with a two stage review process that first determines if PGE has met the statutory requirement under ORS 757.259(2)(e) and then determines if PGE has met the Commission's guidelines.

Q. What are Staff's conclusions from their analysis?

A. Staff concludes that PGE has failed to meet either stage of the review process.

Q. Do you agree with Staff's analysis?

A. No. As we show below, Staff's analysis is flawed and their criteria are incomplete.

A. Staff's Statutory Analysis

Q. Please summarize Staff's statutory analysis of PGE's request.

A. Staff concludes that because PGE does not address how its application satisfies either of the requirements of ORS 757.259(2)(e), it must not meet the statutory requirement (Staff Exhibit 100, page 6). Additionally, Staff concludes that: 1) PGE's application would not minimize the frequency of rate changes; and 2) because FAS 87 expense is an accrual cost and therefore used as a proxy for (but not) actual costs, matching costs and benefits does not occur (Staff Exhibit 100, page 6).

Q. Is their argument correct?

A. No. Staff attempts to frame PGE's pension expense as not an actual cost to the company. In fact, 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). It is also important to note that using FAS 87 expense as the method for recovering pension costs was recently affirmed by the Commission in Order No. 15-226.

Q. Please explain the difference between an incurred and accrued expense.

A. An incurred expense is one where a cost has taken place (e.g., products or services have been delivered) and PGE has received an invoice or other source document that establishes the basis for payment. An example of this is the timesheets submitted by PGE employees. Services have been performed and so the company now incurs the costs associated with them.

An accrued expense is one where a cost has been identified as applicable to the current accounting period (i.e., PGE is now liable for the expense) but PGE has not yet received an invoice or other source document. An example of this is where PGE's last biweekly pay period of the year extends into the next calendar year. In this instance, PGE will accrue the expense for the portion of those timesheets that applies to the current year.

So, just as PGE is liable for wages and salaries incurred by its employees, it is liable for the pension costs that are identified as applicable to a given year. The difference between these two costs is that the wages and salaries are paid directly following the services rendered (i.e., timesheets are submitted), while the pension costs are accrued and later paid upon retirement.

Q. Are accrued benefit payments included in PGE's expense?

A. Yes. Just as expected service costs are accrued for the time period in which FAS 87 expense is determined, so are the expected benefit payments for the year.

Q. Does Staff suggest that PGE's pension plan is imprudent?

A. No. PGE's pension plan is a prudent offering of its total compensation package and FAS 87 expense represents the actual cost of providing this plan over the period of time in which the expense is determined and reflected on PGE's income statement. Thus, the costs and benefits of the FAS 87 expense are matched.

B. Staff's Analysis of the Commission's Guidelines

Q. What criteria does Staff use as the basis for its analysis of the Commission's guidelines?

A. Staff performs their analysis in two phases. First, Staff incorrectly classifies the type of risk PGE faced when it under-forecasted FAS 87 pension expense and whether the variance of actuals to forecast, and reasons for the variance, were within a foreseeable range of risk. Based on their conclusion regarding the type of risk, Staff then analyzes whether the amounts requested are sufficient to warrant PGE's request.

Q. Does Staff's analysis follow the Commission guidelines?

A. Not exactly. The Commission clearly establishes guidelines in Order No. 05-1070 that provide for a systematic and robust analysis of the events leading to and amounts included in the deferral request. Staff, however, never refers to Commission Order No. 05-1070 in their testimony, only partially touching upon the guidelines outlined in Section III above.

Q. What does Staff conclude regarding PGE's request?

A. Staff rather quickly concludes that because PGE forecasts FAS 87 expense in retail prices, it is a foreseeable cost, which falls within a foreseen range of risk. Taken to its' logical conclusion, this would imply that the only unforeseeable cost is one for which the cost category had not been experienced previously.

Q. Does Staff follow-up this conclusion with any additional analysis?

A. Yes. After coming to the above conclusion, Staff performs a cursory analysis, which further concludes that:

1. the variance in expense was within a foreseeable range of risk;
2. the poor returns on pension assets were not unprecedented;
3. because pension costs can swing above or below amounts in prices, they must represent stochastic risk; and
4. as the amounts result from stochastic risk, they are not of a sufficient magnitude to warrant deferral treatment.

Q. Does Staff attempt to define what range of risk is foreseeable?

A. No. Staff simply states that although discount rates have dropped lower than they have been at any time since 1987, they have experienced large decreases before, so the risk is foreseeable.

Q. Has PGE's pension discount rate been subject to variability in the past?

A. Yes. The difference, however, is the <u>magnitude</u> and <u>direction</u> of the variability. The discount rate has risen and declined in the past, but never to this magnitude. As we noted in PGE Exhibit 100, pages 11-12, PGE's discount rate since 2010 has experienced over five times the amount of negative annual change[16] and almost three times the amount of total negative movement,[17] as compared with the entire period prior to 2010.

[16] -0.1 average annual change from 1987-2009, compared to a -0.5 average annual change from 2010-2015.
[17] -1.1% total change from 1987-2009, compared to a -2.9% total change from 2010-2015.

Q. Is Staff correct in its conclusion that PGE's expense was within a foreseeable range of risk?

A. No. As discussed above (Section III, part B), discount rates declined to levels never before seen, contrary to all available forecasts during the UE 215 proceeding. For the following year, PGE's net pension expense for 2012 was more than double the amount set in prices[18] and over three times any amount PGE recorded prior to 2011,[19] while gross pension expense was approximately four standard deviations above the mean for 1987-2010. Net pension expense for 2013 was approximately three and five times these amounts respectively,[20] and gross pension expense was approximately five standard deviations above the mean for 1987-2010. Clearly, these amounts are not within a foreseeable range.

Q. Have PGE's pension assets experienced poor returns in the past as Staff suggests?

A. Yes. While poor returns have been experienced in the past, they are a subordinate cause to the dramatic rise in pension expense. The primary reason and driving force behind the historically high pension expense of the last five years is the dramatic decline in discount rates.

Q. Both Staff and CUB argue that the type of risk involved in PGE's abnormally high pension expense is called stochastic risk.[21] Please define a stochastic model.

A. A stochastic model is a tool for estimating probability distributions of potential outcomes by allowing for random variation in one or more inputs over time. The random variation is usually based on fluctuations observed in historical data for a selected period using standard time-series techniques.

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[18] $13.2 million net pension expense was recorded in 2012, compared with $5.1 million set in prices.
[19] Prior to 2011, $3.9 million in 2006 was the highest recorded pension expense for PGE.
[20] $18.6 million, compared to $5.1 million in prices and $3.9 million in 2006.
[21] Staff Exhibit 100, page 7, and CUB Exhibit 100, page 11.

Q. Has any party ever previously defined stochastic risk?

A. Yes. In Staff's response to PGE Data Request No. 004,[22] Staff states: "stochastic risk is quantifiable and can be represented by a known statistical distribution, and the costs swing above and below those included in rates."

Q. Has any party provided the known statistical distribution for FAS 87 pension expense?

A. No.

Q. Has any party provided a quantitative estimate of the risk?

A. No.

Q. Does PGE forecast its pension expense using a stochastic model?

A. No. The use of stochastic modeling would not be appropriate for forecasting pension expense. Pension expense is based on specific assumptions that rely on recent experience and current projections of bond rates and interest rates that are tied to the actual plan make-up. It would be unreasonable (and would likely be rejected in a rate case proceeding) to forecast pension expense using random variation to determine a non-applicable probability distribution.

Q. Does the magnitude of PGE's request qualify for deferred account treatment?

A. Yes. As discussed above in Section III, because PGE's request meets the Commission's first three discretionary guidelines and the magnitude of PGE's request, with amounts in 2013, for example, representing an increase of 265% over the amount set in retail prices, is material, PGE's request does qualify for deferred accounting treatment.

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[22] Included here as PGE Exhibit 203.

V. PGE Responses to Intervenor Arguments

Q. Does CUB or ICNU make any persuasive arguments regarding PGE's request in this docket?

A. No. Both CUB's and ICNU's arguments appear inconsistent and not relevant to issues in this docket. Rather than focusing on the Commission's guidelines established in Order No. 05-1070, both CUB and ICNU put forth a number of arguments that are red herrings.

A. ICNU's Arguments

Q. Please briefly summarize ICNU's main arguments.

A. ICNU presents four arguments. First, ICNU contends that PGE's request constitutes single-issue ratemaking (ICNU Exhibit 100, page 2). Second, ICNU contends that PGE had the opportunity to earn a reasonable return in both 2012 and 2013 (ICNU Exhibit 100, pages 5-6). Third, ICNU states that because PGE did not file a rate case for 2012 and 2013, we must have believed our pension costs were reasonable (ICNU Exhibit 100, page 6). Finally, ICNU contends that PGE is "cherry-picking" by choosing to single out such a limited time period (ICNU Exhibit 100, pages 6-7).

Q. How does PGE respond to ICNU's first argument that PGE's request constitutes single-issue ratemaking?

A. PGE filed this request in accordance with the clearly defined statutory requirements and guidelines of ORS 757.259, further codified through OAR 860-027-0300. Additionally, PGE has requested that an earnings review be applied. PGE's arguments in Sections II and III above, and PGE Exhibit 100, provide an abundance of evidence that PGE has met both the statutory requirements and the discretionary guidelines as described in Commission Order No. 05-1070.

Q. Does ICNU cite any legal statute or prior Commission Order that would preclude PGE from making its request in this docket?

A. No. ICNU's argument of single-issue ratemaking is subjective and opportunistic.

Q. Did PGE earn a reasonable return in 2012 and 2013 as ICNU suggests?

A. It is important to note that whether or not PGE earned a reasonable return is ultimately a determination to be made by the Commission through an earnings review conducted if and when PGE's deferral request is approved, at the time amortization of amounts is requested. Notwithstanding, PGE under-earned its authorized ROE in both 2012 and 2013. Furthermore, in 2013, PGE's regulated adjusted ROE was more than 350 basis points below its authorized ROE. ICNU claims that the Cascade Crossing write-off and replacement power costs should not be factored into PGE's regulated adjusted ROE for 2013 (ICNU Exhibit 100, page 5). However, Cascade Crossing was a utility project and therefore should be (and was) treated as a utility expense. Similarly, PGE's replacement power costs for the year were a direct result of providing electric service to PGE's customers.

Q. Does the fact that PGE did not file for a general rate case in 2012 and 2013 mean PGE's request is unwarranted?

A. Absolutely not. Assuming that PGE filed for a general rate revision at the same time we filed our original deferral application on August 20, 2012, the earliest new retail prices could possibly have been in effect would have been on or around June 20, 2013. This means that PGE would have had no opportunity to recover any additional expense for 2012 and maybe half a year of additional expense for 2013. When PGE did file a general rate case,[23] pension costs were a primary driver.

[23] Docket No. UE 262 was filed on February 15, 2013.

Q. How does PGE respond to the argument that the company is "cherry-picking?"

A. Again, this argument is not relevant to PGE's request. Deferral requests under ORS 757.259 are specifically designed to allow for the recovery of a discrete set of costs outside of a general rate case filing. After the outcome of UM 1633 limited the scope of PGE's request in this docket, PGE removed 2014 and 2015 since the costs offset and prices had been reset through the general rate case process for both years. Additionally, PGE has requested that an earnings review be applied, which effectively renders this argument moot.

B. CUB's Arguments

Q. Please summarize CUB's testimony in this docket.

A. CUB recommends that the Commission deny PGE's deferral request. CUB reiterates a number of arguments also put forth by Staff and ICNU: PGE's application fails to meet ORS 757.259(2)(e); PGE's prices were just and reasonable; PGE is "cherry-picking"; and the amounts requested by PGE are not material. We have already responded to these arguments above and will not revisit them here. The arguments from CUB not previously raised are as follows:

1. PGE's elevated expense is simply part of a natural fluctuation and therefore normal risk;
2. deferrals are inherently one-sided benefiting the utility; and
3. while PGE's discount rate dropped, we benefitted from increased returns on our pension plan assets.

Additionally, CUB's testimony contains a number of inconsistencies.

Q. Please provide your overall response to CUB's arguments.

A. Similar to ICNU, CUB largely chooses to ignore the Commission's guidelines and instead, provides arguments that have no relevance to the issues in this case. In addition, CUB at times uses outdated forecast information and mismatched data to arrive at their conclusions.

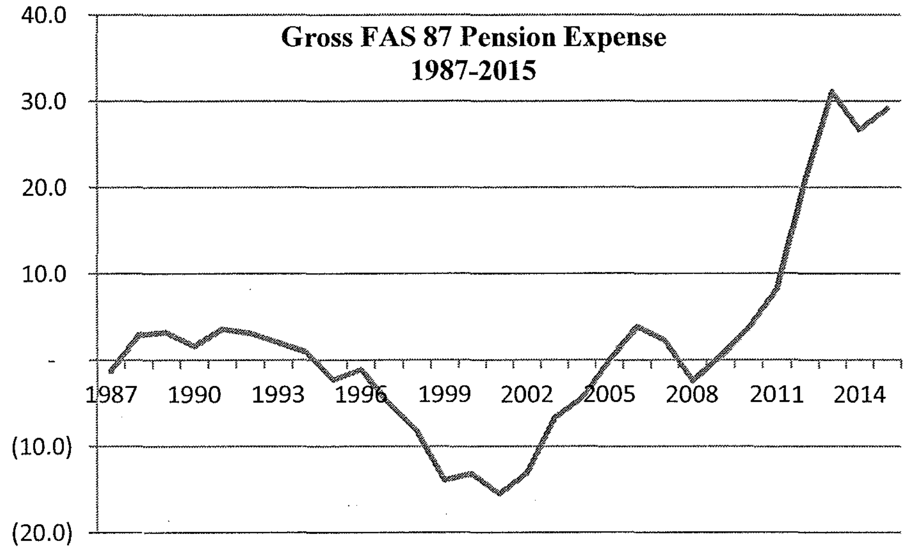
Q. Was the increase to PGE's pension expense for 2012 and 2013 just "normal fluctuation" as CUB suggests?

A. No. As we clearly describe and support above, the increases to PGE's pension expense in 2012 and 2013 were unprecedented. We agree that there are natural fluctuations to any forecast; however, the extreme elevation of pension expense beginning in 2012 and continuing to the present is not a natural "fluctuation around the mean" (CUB Exhibit 100, pages 14). PGE's 2012 pension expense was four times the actual amount recorded in 2010; the 2013 expense was six times the amount recorded in 2010; and pension expense for 2014 and 2015 has remained at between four and five times the amount recorded in 2010.

Q. Is the chart CUB provides to illustrate their fluctuation argument accurate (CUB Exhibit 100, Figure 2)?

A. Not exactly. Their chart is misleading, as it uses gross pension expense amounts for all years except 2014, where they use a net pension expense amount. Figure 3 below, uses gross pension amounts for every year and includes 2015. Clearly, amounts beginning in 2012 began to deviate from the mean and continue to do so.

Figure 3



Q. Is there an inherent utility bias in deferral requests as CUB suggests (CUB Exhibit 100, page 17)?

A. Utilities do have internal information at their disposal that outside parties may not have, but there is external information (e.g., forecasts of interest rates, escalation rates, and consumer prices) that can assist CUB and other intervenors in deciding whether to file a deferral request. Additionally, for most deferral filings, PGE is subject to an earnings review. This ensures that PGE does not over earn its authorized ROE due to the recovery of deferred costs.

Q. Does PGE's earnings history demonstrate the use of selective deferred accounting applications to create over-earning situations?

A. No. Since 1987 PGE has under-earned its ROE by an average of 90 basis points, under-earning in 19 out of the 28 years during that period. In short, history shows that PGE is subject to more downside risk than upside risk.

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

A. No. As we state in PGE Exhibit 100, 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. Have any recent applications for deferred accounting proposed refunding money to customers?

A. Yes. On December 31, 2015, PGE submitted an application for deferred accounting requesting to return to customers, the revenue requirement effect related to a $140 million debt issuance that would lower PGE's cost of debt as compared to what was authorized in UE 294 (2016 test year).

Q. Has PGE's pension fund performance been improving and is it likely that PGE's pension plan will soon become fully funded as CUB suggests (CUB Exhibit 100, page 15)?

A. No. CUB is using a forecast from 2012 to support its suggestion. This forecast information is dated and it does not match PGE's recent pension plan experience. As of December 31, 2015, PGE's pension plan assets were valued at $550 million compared with an obligation of $758 million; in other words, PGE's pension plan is underfunded by $208 million.[24] This compares to a year-end underfunded amount of $77 million in 2010, $109 million in 2013, and $186 million in 2014.

[24] PGE's fair value of assets (FVA) versus the projected benefit obligation as of 12/31/15.

Q. Did the improving stock market have an equal and offsetting positive impact on PGE's pension expense as CUB suggests (CUB Exhibit 100, pages 17-18)?

A. No. Compared with PGE's expected return on assets (EROA) from 2008-2015, PGE's actual returns over the same period have under-performed by $111 million.[25] While the better than expected market returns in 2012 and 2013 had a positive impact on PGE's pension plan, they did not make up for recent losses and did not have a substantial impact on lowering PGE's pension expense. Moving a pension plan out of an unfunded position can be difficult and usually requires taking on greater risk. The additional risk, however, would tend to create even greater volatility in the plan.

Q. Were the higher than expected market returns for 2012 and 2013 the catalyst in reducing PGE's prepaid pension asset (CUB Exhibit 100, page 18)?

A. No. While this issue raised by CUB is not pertinent to the issue at hand, we believe it is important to clarify this misconception. As discussed, PGE's market returns have not improved the funded status of the plan from 2008-2015. What has reduced PGE's prepaid pension asset is the elevated level of expense PGE has incurred, coupled with the MAP-21 pension funding stabilization provision, which pushed out PGE's need to make required cash contributions into the plan. When the MAP-21 provisions begin to be phased out and if PGE's funded status has not dramatically improved, very large cash contributions will be required, greatly increasing PGE's prepaid pension asset.

Q. Does CUB have any other arguments to support their position?

A. No.

[25] As demonstrated in PGE's first supplemental response to CUB Data Request Number 005, Attachment B, provided here as PGE Exhibit 202.

VI. Summary

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

A. As demonstrated above, PGE's request for deferred accounting treatment meets both the statutory requirements and discretionary guidelines for Commission approval. 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. PGE's request matches these unforeseen pension costs with the benefits that customers received. As the triggering event of historically low discount rates was significant and created by unforeseeable economic conditions, the magnitude of PGE's request meets the Commission's standards for approval.

As such, 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 prices for FAS 87 expense covering the period of August 22, 2012 through December 31, 2013.

Q. Does this conclude your testimony?

A. Yes.

List of Exhibits

PGE Exhibit	Description
201	PGE's response to OPUC Data Request No. 237, Attachment 237-A for UE 215
202	PGE's first supplemental response to CUB Data Request Number 005, Attachment B
203	Staff's response to PGE Data Request No. 004

Portland General Electric Company

PGE Pension Plan Projections ($000s)

	2009	2010	2011	2012	2013	2014	2015
Funding Valuation Results							
Funding Target	$ 348,719	$ 424,386	$ 442,162	$ 450,368	$ 456,034	$ 460,140	$ 464,239
Target Normal Cost	$ 12,281	$ 13,529	$ 12,825	$ 12,678	$ 11,974	$ 13,138	$ 14,309
Market Value of Assets	$ 343,746	$ 405,700	$ 415,012	$ 437,486	$ 457,124	$ 474,519	$ 477,852
Funded Percentage							
Value of Plan Assets (6-month smoothing)	$ 378,121	$ 389,653	$ 413,176	$ 435,452	$ 454,987	$ 472,289	$ 475,568
Funded Percentage	108%	80%	93%	96%	100%	103%	102%
Prefunding Balances, After Waivers	$ 10,887	$ 1,068	$ 0	$ 0	$ 0	$ 0	$ 0
FTAP	105%	89%	93%	97%	100%	103%	102%
Minimum Required Contribution (as of January 1)							
Target Normal Cost	$ 12,281	$ 13,529	$ 12,825	$ 12,678	$ 11,974	$ 13,138	$ 14,309
Shortfall Amortization	0	5,421	5,572	3,862	2,038	0	0
Credit for Excess Assets	(18,515)	0	0	0	0	(12,149)	(11,329)
Minimum Required Contribution	$ 0	$ 18,950	$ 18,397	$ 16,540	$ 14,012	$ 989	$ 2,980
Less: Funding Balances Applied	0	13,892	0	0	0	0	0
Plan Year Cash Contribution	$ 0	$ 5,058	$ 18,397	$ 16,540	$ 14,012	$ 989	$ 2,980
Contribution Schedule (Fiscal Year)							
January 15	$ 0	$ 0	$ 0	$ 4,139	$ 3,721	$ 3,153	$ 223
April 15	0	0	4,139	3,721	3,153	223	0
July 15	0	0	4,139	3,721	3,153	223	0
September 15	0	0	5,643	2,794	2,514	2,129	150
October 15	0	0	4,139	3,721	3,153	223	0
Total	$ 0	$ 0	$ 18,061	$ 18,098	$ 15,693	$ 5,950	$ 373
Accounting Valuation Results							
Projected Benefit Obligation	$ (467,189)	$ (491,347)	$ (468,741)	$ (478,195)	$ (485,555)	$ (491,807)	$ (496,767)
Fair Value of Assets	347,366	405,709	409,411	432,128	455,163	474,853	484,861
Funded Status	$ (119,823)	$ (85,638)	$ (59,330)	$ (46,067)	$ (30,392)	$ (16,954)	$ (11,906)
Prior Service Cost	$ 2,434	$ 2,822	$ 1,935	$ 1,198	$ 775	$ 352	$ 93
Net (Gain)/Loss	201,877	166,951	137,788	139,495	135,940	128,496	122,569
Pre-Tax/Pre-Reg Adj AOCI	$ 204,311	$ 169,773	$ 139,723	$ 140,693	$ 136,715	$ 128,848	$ 122,662
Market-Related Value of Assets	$ 495,294	$ 484,745	$ 467,241	$ 462,372	$ 455,259	$ 480,138	$ 487,675
Service Cost	$ 11,311	$ 11,370	$ 9,741	$ 9,104	$ 9,022	$ 8,537	$ 8,347
Interest Cost	31,181	28,202	29,608	30,168	30,565	31,212	31,382
Expected Return on Assets	(43,240)	(40,076)	(39,211)	(38,945)	(38,129)	(39,805)	(40,071)
Amortization of Prior Service Cost	690	887	737	423	423	259	93
Amortization of (Gain)/Loss	411	3,358	2,954	5,651	8,243	7,160	6,931
Total Expense	$ 353	$ 3,741	$ 3,829	$ 6,401	$ 10,124	$ 7,363	$ 6,682
Cash Flows							
Contributions	$ 0	$ 0	$ 18,061	$ 18,098	$ 15,693	$ 5,950	$ 373
Benefit Payments	$ 26,825	$ 27,077	$ 26,897	$ 31,133	$ 32,207	$ 33,692	$ 35,256
Assumptions							
Effective Interest Rate	8.23%	6.63%	6.48%	6.49%	6.49%	6.50%	6.50%
Discount Rate	6.90%	5.90%	6.50%	6.50%	6.50%	6.50%	6.50%
Long-Term Rate of Return	9.00%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%
Asset Return Experience	9.00%	8.50%	8.50%	8.50%	8.50%	8.50%	8.50%
Comments							
At-Risk/Benefit Restrictions	No	No	No	No	No	No	No

	Expected Return on Assets	Actual Return on Assets[1]
2003	$ 40,340,000	$ 97,171,219
2004	$ 40,625,000	$ 43,003,932
2005	$ 40,616,000	$ 29,224,977
2006	$ 41,380,000	$ 58,723,287
2007	$ 42,436,000	$ 40,773,197
2008	$ 44,955,000	$ (144,725,321)
2009	$ 43,239,547	$ 83,103,542
2010	$ 40,076,010	$ 59,573,724
2011	$ 42,199,778	$ 13,374,079
2012	$ 41,558,173	$ 78,317,759
2013	$ 40,509,870	$ 90,541,012
2014	$ 39,320,350	$ 44,239,265
2015	$ 40,035,686	$ (3,820,010)

(1) Please note, actual returns are gross amounts and are not netted against investment manager fees

Date: February 12, 2016

TO: PORTLAND GENERAL ELECTRIC
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FROM: Brian Bahr
Senior Financial Analyst
Energy Rates, Finance & Audit Division

OREGON PUBLIC UTILITY COMMISSION
Docket No. UM 1623 – PGE 2nd Set Data Request (004)

Data Request PGE 004:

004. Staff has described pension expense volatility as stochastic risk (Staff Exhibit 100, page 7).
   a. Please provide Staff's definition of stochastic risk.
   b. Please provide the known statistical distribution of pension expense.
   c. Please describe how Staff would estimate and include this risk in a normalized future test year during a general rate case.

Staff Response to PGE 004:

004.
   a. Stochastic modeling is a method of financial modeling in which one or more variables within the model are random. Stochastic modeling is for the purpose of estimating the probability of outcomes within a forecast to predict what conditions might be like under different situations. The random variables are usually constrained by historical data, such as past market returns. (Investopedia) Based on Order No. 04-108, stochastic risk is quantifiable and can be represented by a known statistical distribution, and the costs swing above and below those included in rates.
   b. Staff has not performed this calculation for pension expense; however, the Company has the necessary information to calculate a statistical distribution for the difference between forecasted and actual pension expense.
   c. Staff would follow the guidance provided in Order No. 15-226, in which the Commissioners affirm the current practice of forecasting FAS 87 expense for the test year.