BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 262

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In the Matter of	)
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PORTLAND GENERAL ELECTRIC COMPANY	)
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Request for a General Rate Revision.	)
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REBUTTAL TESTIMONY
OF THE
CITIZENS' UTILITY BOARD OF OREGON

August 6, 2013

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My name is Bob Jenks, Executive Director at the Citizens' Utility Board of Oregon (CUB), and my qualifications set forth in CUB Exhibit 101. My name is Jaime McGovern, Senior Utility Analyst at CUB and my qualifications are set forth in CUB Exhibit 201.

I. Introduction

To quote the American Academy of Actuaries:[1]

- *Pension Funding – the cash contributions that are made to the pension plan. Pension funding is governed by laws described in the Internal Revenue Code (IRC), which determine the annual minimum required contribution and the annual maximum tax-deductible contribution.*

- *Pension Accounting – the annual pension expense calculation and disclosure of a pension plan's assets and liabilities in a company's*

[1] American Academy of Actuaries (2004, July). *Fundamentals of Current Pension Funding and Accounting for Private Sector Pension Plans: An Analysis by the Pension Committee of the American Academy of Actuaries*, pg 2. Retrieved from http://www.actuary.org/pdf/pension/fundamentals_0704.pdf.

> *financial statement. The Financial Accounting Standards Board (FASB) governs pension accounting under generally accepted accounting principles (GAAP) in the U.S.*
>
> *Amounts calculated under pension funding rules are completely different than those calculated for pension accounting, and one must be careful not to mix the two topics.*

Unfortunately, the Company has done exactly that. It is asking for the Commission to approve ratemaking regarding, not pensions, but an entity known in the accounting literature as the prepaid pension cost. The Company assigns the misnomer *prepaid pension asset* to this accumulated accounting entry; however, it does not act like an asset, and can take on negative or positive values. In fact, all the way through 2005, the Company referred to the accumulated amount as prepaid pension cost as well.[2] Therefore, CUB will refer to the accumulated sum as the prepaid pension cost, the standard terminology in the industry.

CUB opposes the proposed ratemaking treatment for pensions in the current docket (and therefore going forward), for many reasons, as explained below. Alternatively, CUB proposes that ratemaking for PGE's pension should be based on cash contributions. PGE objects to CUB's proposal, so as a secondary alternative, CUB proposes continuing ratemaking based on FAS 87. However, in recognition that accurate forecasting of FAS 87 has proven to be impossible, CUB proposes the use of a three year rolling average of actual FAS 87 expenses.

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[2] PGE 2004 Form 10-k, filed March 11, 2005. Retrieved from: http://investors.portlandgeneral.com/secfiling.cfm?filingID=784977-05-7.

II. Accrued Versus Cash Accounting

The root of CUB's concern is the Company's treatment of accrued accounting expenses as current costs, which the Company must bear and fund. Although CUB explains why FAS 87 expense and prepaid pension costs should not be confused with real costs, the Company asserts that these are, in fact, real costs.[3] The Company, oversimplifies the matter. Pension expense, also known as FAS 87 expense, is an actual liability that the Company accrues (yet doesn't fund), subject to changes in market conditions every year, over the lifetime of the pension plan. Interestingly, as we will detail below, in one year, pension expense can be negative, inferring a credit due, while in the very next year, it can be positive, with absolutely no outlay from the Company or shareholders whatsoever, inferring future liability.

To establish ratemaking based on the prepaid pension cost would be to combine treatment of pension accrual accounting (via FAS 87 amounts) with that of pension cash funding (via cash contributions). This request is contrary to the original argument that the Company made in UE 79, where it recommended the switch to FAS 87 or accrual accounting for ratemaking treatment over the previous cash basis accounting method.[4] Then, the Company posited that accrual accounting better matches the timing of rate recovery with the timing of service provided, thereby making it more suited to the "used and useful" statute used by the Commission.[5]

To demonstrate the disconnect between FAS 87, the current basis for pension ratemaking, and cash contributions, consider the following facts:

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[3] UE 262 - PGE/1800/Hager-Jaramillo/4, lines 15-22.
[4] UE 79/PGE/Part 1C, page 38 of 91.
[5] *Ibid.*

1. The Company's shareholders made contributions in only [redacted] of past 27 years, including the current year. However, in [redacted] of past 27 years, FAS 87 expense, the basis for pension ratemaking, was positive.[6]
2. Although analysis is limited by the unavailability of data prior to 1997, we can see that since FAS 87 ratemaking was implemented, ratepayers' rates based on FAS 87 showed positive amounts (costs) in [redacted] years, while FAS 87 expense was actually negative (credit). The Company was not only enjoying a negative pension expense, but also refraining from making contributions to the pension fund.[7]

These facts certainly call into question how FAS 87 expense is an appropriate basis for ratemaking when negative expenses impose positive costs for ratepayers. The answer is that FAS 87 accounting regulation was never intended for ratemaking. It was constructed as a transparency instrument for investors, so that they would more accurately be able to assess the long term indebtedness of a company and therefore accurately price the company's stock, leading to more informed investment, and accountability of the company.[8]

Aside from the theoretical inconsistency associated with mixing pension accounting and pension funding (they don't both show up consistently on the income statement and balance sheet), the practical complications of ratemaking based on some formulaic mix of these two components is that pension funding addresses the standards by which a company must make contributions in the short term, and pension accounting addresses long term future liability dependent upon many unrevealed factors in the long term.

Again, the American Academy of Actuaries:

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[6] UE 262 - CUB Confidential Exhibit 202.
[7] *Ibid*.
[8] http://www.fasb.org/summary/stsum87.shtml

> *The cash contribution and pension expense calculations are both often referred to as the cost of a pension plan – one as a cash outlay and the other as a reduction (or increase) in company earnings. Both are calculated using similar principles, although the rules for calculation are very different.*[9]

Even seemingly straightforward rules, such as the minimum funding levels, are not consistent across FAS 87 and GAAP (represented by the Pension Protection Act of 2006).

III. Ratemaking on the Prepaid Pension Cost is Retroactive Policy

The prepaid pension cost is historically cumulative. CUB made this argument in its Opening Testimony, yet the Company did not address this important point in its Rebuttal Testimony. The Company asserts that the implementation of the Pension Protection Act (PPA) in 2008 was the impetus for its interest in earning a return on the prepaid pension cost.[10] However, the prepaid pension cost had reached [redacted] before 2008, and has only accumulated [redacted] since then.[11] The prepaid pension cost grew by an average of [redacted] per year between 1998 and 2006, but grew by half that, at an average rate of [redacted] per year during the five years following the PPA.[12] Therefore, the majority of the balance on which the Company is asking to earn an ongoing return, existed long before the current rate period, and certainly before the Pension Protection Act took effect.

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[9] American Academy of Actuaries (2004, July). *Fundamentals of Current Pension Funding and Accounting for Private Sector Pension Plans: An Analysis by the Pension Committee of the American Academy of Actuaries*, pg 2. Retrieved from http://www.actuary.org/pdf/pension/fundamentals_0704.pdf.
[10] UE 262 - PGE/1800/Hager-Jaramillo/1.
[11] UE 262 - CUB Confidential Exhibit 202.
[12] UE 262 - CUB Confidential Exhibit 102.

<u>CUB Chart 1:</u>[13]

[redacted]

In the Company's response to CUB's DR 282 in UE 262, the Company provides the data that demonstrates the prepaid pension cost growing since 1993,[14] and states in its Rebuttal Testimony that the prepaid pension cost evolves from the difference between cash contributions and FAS 87 expense.[15] Notice, by definition below, that prepaid pension cost is historically cumulative, directly implying that any policy made on the prepaid pension cost is policy on the entire legacy of annual balances. The American Academy of Actuaries uses a similar definition to that of PGE, but makes clear that the prepaid pension cost is an accumulation of past costs and contributions:

> *The accrued or prepaid pension cost is the amount on a company's balance sheet that is equal to the accumulated difference between past net periodic pension costs (NPPC) and past plan contributions. A prepaid pension cost arises when the plan contributions exceed the NPPCs and/or the NPPCs are less than zero.*[16]

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[13] UE 262 - CUB Confidential Exhibit 202.
[14] UE 262 - CUB Confidential Exhibit 202.
[15] UE 262 - PGE/1800/Hager-Jaramillo/9, lines 15 -16.
[16] American Academy of Actuaries (2004, July). *Fundamentals of Current Pension Funding and Accounting for Private Sector Pension Plans: An Analysis by the Pension Committee of the American*

To include the prepaid pension costs in rates is to include the sum of all historical differences between plan contributions and Net Periodic Pension Costs ("NPPC"), also known as FAS 87 expense. Of course, this approach has several major problems. The first concern is the fact that current and future ratepayers would be held responsible for the past pension decisions of the Company absent a prudency review under the ratemaking process. For example, this could include a revision in the pension plan more than a decade ago to double the amount of pension compensation, or to irresponsibly invest in risky assets for the pension fund.

IV. Risk, Rate of Return and Prudency

Investments are added to rate base and eligible for a rate of return only if they were prudently made. This requires a prudency review of pension contributions and negative FAS 87 expenses, both elements which created the prepaid pension cost that is proposed for rate base. As shown in CUB Exhibit 202, PGE's pension obligation was [redacted] in 1987. The present value of its pension plan assets was [redacted] and the FAS 87 expense was [redacted], which was added to the prepaid pension cost. The following year, the obligation grew to [redacted]. The present value of the assets grew to [redacted], and PGE made a pension contribution of [redacted] (FAS 87 expenses was [redacted]). Both the negative FAS 87 expense in 1987 and the pension contribution in 1988 contributed to the cumulative value of the prepaid

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Academy of Actuaries, pg 10. Retrieved from http://www.actuary.org/pdf/pension/fundamentals_0704.pdf. Please note: The NPPC is comprised of three estimated current factors (1) service cost (2) interest cost and (3) expected return on assets and the recognition of three historical amortized components (4) amortization of prior service cost (5) amortization of actuarial gains and losses and (6) amortization of transition obligations. The company refers to NPPC as pension expense and does not mention the inclusion of amortization of transition obligations, the phased recognition of pension expense from when the Company first transitioned to FAS 87 reporting.

pension cost, on which the company seeks to earn its authorized rate of return. What is the basis to conclude that the negative FAS 87 expense in 1987 and the pension contribution in 1988 represented prudently incurred expenses, costs or investments?

Even if one accepts the argument that some of the prepaid cost represents shareholder investment in the pension, what is the basis of paying the currently authorized rate of return? Considering that return is the primary and natural vehicle for incentivizing and tempering risk, there is lack of risk in a return that is rewarded ex-post, especially a return that compensates for market loss. The primary risk for a pension manager is the investment in pension assets. But if customers pay the FAS 87 expense and the utility's rate of return on any contributions in excess of the expense, what risks are shareholders taking? The only significant risk to shareholders is that the PUC would find imprudence in PGE's management of its pension.

PGE testifies that its pension performance in the last five years has been in the top 1%, and had been better than average over the last 10 years.[17] Although that is commendable, it doesn't demonstrate prudence. Moreover, that is not the period for which it is asking for a return on the prepaid asset. The period that the prepaid asset encompasses is much longer than that. To determine whether a rate of return on prepaid asset is reasonable, it is necessary to look at the prudence over the life of the buildup of the asset. A prudence review does not just include the current management of PGE, but how PGE has managed the asset over several time periods. As we can see in the chart below, much of the prepaid asset at PGE ([redacted]%) grew during the years of Enron ownership (1997-2006).

[17] UE 262 - PGE/1800/Hager-Jaramillo/6.

CUB Chart 2:[18]

[redacted]

The prepaid asset was [redacted] at year end 1996, immediately preceding Enron ownership and it was [redacted] when Enron spun PGE off in 2006. Thus, Enron's ownership represents [redacted] of PGE's current prepaid pension management. In 1997, when Enron took ownership, PGE's pension was healthy. Its liabilities (also known as pension benefit obligation) were [redacted]. Its assets were [redacted]. After PGE's IPO in 2006, the pension assets barely covered its liabilities. The pension accounting created [redacted] in negative FAS 87,[19] improving the Company's balance sheet in [redacted] of those years.

Inherent in the request for rate base like treatment of its prepaid pension cost is the requirement that the management of that pension is held to a prudency standard and that the "investment" in pension has a risk associated with it. This standard must be applied to the management during the years that the prepaid pension cost was developed.

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[18] UE 262 - CUB Confidential Exhibit 202.
[19] UE 262 - CUB Confidential Exhibit 102.

For PGE, most of those years comes from a period of time that predates the current ownership model.

In its Opening Testimony, CUB pointed out that because prepaid pension costs were not allowed recovery under Oregon ratemaking at the time of PGE's IPO, that the then existing [redacted] in prepaid costs were priced into the stock value during the initial public offering.[20] PGE's response was that the PPA changed all of this.[21] But [redacted] of the prepaid asset that PGE is asking for recovery on predates the PPA and [redacted] predates the 2006 initial public offering during the Enron bankruptcy.[22] Allowing recovery of a return on the prepaid asset requires a review of the prudency of the management of the pension fund during the time period that the prepaid asset developed. This includes the period of time when the pension went from overfunded to underfunded and the time that the prepaid asset was growing due to negative FAS 87.

V. The Prepaid Pension Cost Has Arisen Largely From Negative FAS 87 Expense In Consecutive Years of Zero Contribution by the Company.

The second problem associated with the calculation methodology of prepaid pension cost is evident from the last sentence of the American Academy of Actuary's definition above, which we repeat here for efficiency:

> *A prepaid pension cost arises when the plan contributions exceed the NPPCs and/or the NPPCs are less than zero*.[23]

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[20] UE 262 - CUB/100/Jenks/13.
[21] UE 262 - PGE/1800/Hager-Jaramillo1, lines 17-19.
[22] UE 262 - CUB Confidential Exhibit 202.
[23] American Academy of Actuaries (2004, July). *Fundamentals of Current Pension Funding and Accounting for Private Sector Pension Plans: An Analysis by the Pension Committee of the American Academy of Actuaries*, pg 10. Retrieved from http://www.actuary.org/pdf/pension/fundamentals_0704.pdf.

The above description, along with the information provided by the Company in CUB Confidential Exhibit 202,[24] makes it clear that much of the prepaid pension cost has evolved from negative FAS 87 expense. There is no magic in the math. A large prepaid pension cost (on which the Company would like a return) can arise from (1) a large contribution and negligible or negative FAS 87 expense, or (2) (which has more often been the case for the Company) a negligible or zero contribution and large negative FAS 87 expense.

Let us use some of PGE's own data as an example of the disconnection between ratepayer contribution, shareholder contribution, and FAS 87 expense, resulting in the prepaid pension cost.

CUB TABLE 1:[25]

[redacted]

The sequence of events goes like this: In 1999, the Company has a significant pension benefit obligation, negative FAS 87 expense, and collects [redacted] dollars in rates. However, it doesn't make any contribution to the pension trust, and despite actual return on plan assets being [redacted] what they were estimated to be, the prepaid pension cost (the item on which the Company is requesting a return) almost [redacted]. The following year, the Company again collects pension expense in rates, despite a negative

[24] See CUB Confidential Exhibit 202
[25] Excerpt from UE 262 – CUB Confidential Exhibit 202.

FAS 87 expense, but does not contribute to the pension trust. However, in 2000, the actual return on plan assets is starkly below estimates and the prepaid pension cost grows by [redacted] dollars while the pension benefit obligation grows by [redacted] dollars.

This demonstrates several things. First, the Company is able to collect in rates via a regulatory system, based on FAS 87 expense, even when FAS 87 expense is negative, while simultaneously making no contribution to its pension plan. This can happen even while there is a significant pension benefit obligation to the pensioners and the prepaid pension cost is growing. In fact, because the prepaid pension cost can be positive whenever FAS 87 expense is negative, regardless of contributions, ratepayers are being asked to finance this prepaid pension cost (under PGE's proposal) indefinitely, even when the Company has made no capital outlay whatsoever.

VI. Prepaid Pension Cost Is Not Likeable To Revenue Producing Depreciating Asset and Does Not Consistently Amortize Down to Zero.

The Company attempts to support the request of a return on the prepaid pension cost by likening it to income producing assets:

> *The costs of PGE's pension plan are similar to the standard accounting practice of depreciating physical assets, where the capital cost of the asset is amortized over the life of the plan, matching the overall capital costs with the multiyear benefits.*[26]

However, there are several fundamental flaws with this argument. First, the prepaid pension cost is not an asset at all. Rather, it is an accounting expense. In fact, in

[26] UE 262 - PGE/1800/Hager-Jaramillo/6, lines 21-23.

all of the accounting literature that CUB has found, including the Company's own annual reports up through 2005, it is called a prepaid pension cost, which is an accounting asset to the company when it is positive and a liability when it is negative.

Second, it is not an income producing asset, or an asset providing current service to ratepayers. Several costs are included in the prepaid pension cost, and many of them are historical and amortized, including plan transition costs and prior service costs.

Third, the capital assets that are generally included in rate base have demonstrated useful lives, with parameters that are reviewed and agreed upon by industry standards, the utility, the Commission and interested parties. For example, when looking at a wind farm, its depreciation curves look different from that of a coal plant or a hydro plant, but they are all included in rate base based on their useful lives. However, this prepaid pension cost is amortized over the length of the obligation, not depreciated over the life of the plan. The depreciation is not predictable. It fluctuates annually, based on forecasted elements such as interest rates and return on plan assets. Moreover, the Company has provided no evidence that the prepaid pension cost will ever 'depreciate' to zero, regardless of how much money is collected in rates from ratepayers. In fact, even though the pension fund is closed, the forecasts provided by the Company support the argument that the prepaid pension cost will be over [redacted] in 2023.[27] Although this (forecasted) number is smaller than the 2020's [redacted][28] prepaid pension cost, there is no guarantee that it will amortize to zero at any predictable rate, as it is forecasted to shrink from its current balance of over [redacted][29] to [redacted] in 2014,[30] then rise

[27] UE 262 - CUB Confidential Exhibit 202.
[28] UE 262 - CUB Confidential Exhibit 202.
[29] UE 262 - CUB Confidential Exhibit 202.
[30] UE 262 - CUB Confidential Exhibit 202.

again, by the Company's own testimony. This behavior of the prepaid pension cost is in no way similar to income producing capital assets currently allowed in rates.

VII. Timing Is Everything

In its Rebuttal Testimony, the Company dismisses the existence of the prepaid pension cost as merely "timing differences between contributions to PGE's pension plan and when these contributions are expensed."[31] The Company also states "[t]he prepaid asset effectively amounts to a difference in timing between the two: pension expense and cash contributions."[32] Anyone familiar with elementary finance (even a home mortgage) and ratemaking knows that timing is important. The Company is authorized to recover in rates amounts that reflect items and services that are used and useful. With regards to pension expenses, only the current service cost component (out of five other components) is the cost reflected in the current period. More importantly, timing is exactly what the Company is intending to capitalize by requesting a return on the prepaid pension cost. By deeming this historically accumulated expense an asset, instead of a cost, PGE is attempting to treat it as an income producing asset that has a useful life going forward. However, allowing return on the prepaid pension cost, a cost with an accumulation history of several decades, would give the Company the right to earn a return on the timing difference between when the cost was charged and when it was in service. Not only does this automatically generate several decades worth of returns for the Company, it completely circumvents the regulatory process by not subjecting these costs to Commission approval at the time that they were incurred and/or in service.

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[31] UE 262 - PGE/1800/Hager-Jaramillo14, lines 8 -9.
[32] UE 262 - PGE/1800/Hager-Jaramillo/9, lines 15-16.

VIII. The Company Dismisses CUB's Objection to Treating FAS 87 Expense As A Real Cost As A Misunderstanding Between Accrued and Incurred Expenses

Not only does CUB recognize the difference between accrued and incurred expenses, as demonstrated in its original testimony,[33] it believes that this distinction is important. In particular FAS 87 expense, one of the factors used to calculate the prepaid pension cost, is an estimate of a future liability to pensioners based on a myriad of forecasted economic elements, as noted above. It is not a record of historical or current cash contributions which necessitate a return on investment. To confuse current costs with these estimates of future liability would, for the purpose of ratemaking, be asking the Commission to base its decision on factors well beyond the test year, factors that cannot be committed to either by the Company's actuaries, or the Company itself. Moreover, it seems from the original case UE 79, in which FAS 87 ratemaking was adopted, the Company also agreed that incurred expenses and accrued expenses are markedly different.

> *In brief, the new guidelines change the method for recognizing post-retirement benefits other than pensions from a cash basis to an accrual basis. PGE will recognize the cost associated with providing such benefits (primarily post-retirement medical and life insurance) during the years that its employees provide service to the Company. In the past, PGE has recognized such costs (when paid) during an employee's retirement years.*[34]

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[33] *See* UE 262/CUB 100/ page 2 lines 22- page 3, which states: "*The Commission should concern itself with the date at which pensions impose real costs on the utility, and the burden of those real costs, which are the **cash contributions.**"*

[34] UE 79 – PGE/Winter Exhibit 3D, pages 15-16

Although in the present case, the Company is referring to retirement obligations other than pensions, the distinction between the accounting treatments and the effect is clear. The Company points out that with the accrual method for accounting, costs are recognized on the balance sheet before they are paid out, whereas previous treatment (i.e. incurred costs) recognized those costs when the Company paid out the money. There is nothing to suggest that these two approaches overlap, or can be combined. In fact, doing so would result in double counting. Therefore, assigning ratemaking treatment based on cash contributions (incurred costs) minus FAS 87 amounts (in accrual accounting) would be confusing incurred and accrued expenses. CUB is not confused, and recommends regulatory treatment based on one of these principles, not both.

The Company further addresses its interests in the accrual method of accounting when it proposed adopting FAS 87 accounting for pensions.

> ***Q. Is the proposed change consistent with industry standards?***
> *Yes. The accrual basis of accounting is generally preferable to cash basis accounting. The new method better matches costs with benefits and is similar to PGE's accounting method for pensions.*
>
> ***Q. What is the effect of the change on PGE in 1991?***
> *Adoption of the new guidelines will increase recorded expenses by $1.5 million. The amount is based on actuarial estimates*.[35]

In that seminal case, UE 79, where the Company stood to benefit that year from the alteration in ratemaking treatment, it made note of the fact that accrual accounting would allow the Company to match up expenses with benefits to ratepayers. The Company argued for pension ratemaking based on FAS 87 expense, claiming the ratemaking treatment would be more appropriate to the way that the company accounted

[35] UE 79 – PGE/Winter, page 38 of 91 in Part 1C.

for its pensions. This methodology was adopted, and has been the standard treatment for the past two decades.

IX. Long-term Projections Have a Large Element of Uncertainty Inherent In Their Calculations

The Company and CUB are in agreement on this point:

> *While PGE's third party actuaries have been accurate in forecasting PGE's near-term pension expense, long-term projections are by nature more difficult and less accurate.*[36]

The American Academy of Actuaries provides additional insight on this issue:

> *Expected Long-term Rate of Return on Assets – This assumption is only used for pension accounting. It is used to determine the expected return on assets during the year. This assumption reflects the average rate of earnings expected on current and future investments to pay benefits. It is a long-term assumption that is reviewed regularly but generally changes when the long-term view of the market changes or with shifts in the plan's investment policy.*[37]

The very nature of the pension benefit obligation, and all of its inferred counterparts, including the prepaid pension cost, are inherently dependent on estimates of values far in the future. The final calculation for the pension benefit obligation for the Company is defined by the amount that at some time in the present, the Company will owe its retirees. Inherent in that amount, down to the last surviving retiree's entitlements, are forecasts on salary progression, expected years of service, longevity, service attrition rates and other employee considerations. Those are just the non-economic factors. When the Company must back track to calculate how much it must put away to make sure that it can make

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[36] UE 262 - PGE/1800/Hager-Jaramillo/11, lines 14-16.
[37] American Academy of Actuaries (2004, July). *Fundamentals of Current Pension Funding and Accounting for Private Sector Pension Plans: An Analysis by the Pension Committee of the American Academy of Actuaries*, pg 4. Retrieved from http://www.actuary.org/pdf/pension/fundamentals_0704.pdf.

good on those payments decades into the future, it must take into consideration anticipated rates of return on assets, discount rates, cost of debt and equity, etc.. The financial debacle beginning in 2008 made it evident to everyone that the economy and asset rates of return are anything but predictable.

The Company acknowledges these inherent fluctuations to its shareholders in its annual report:

> *Pension expense is dependent on several assumptions used in the actuarial valuation of the plan. Primary assumptions include the discount rate, the expected return on plan assets, mortality rates, and wage escalation. These assumptions are evaluated by PGE, reviewed annually with the plan actuaries and trust investment consultants, and updated in light of market changes, trends, and future expectations. Significant differences between assumptions and actual experience can have a material impact on the valuation of the pension benefit plan obligation and net periodic pension cost.*[38]

In particular, long term market performance since the Great Depression has been impressive, beating treasury rates over the long haul unquestionably. However, in the short term, many analysts saw a flight to quality during the Great Recession when return on assets was negative or close to nothing. Therefore, it is inappropriate to assess short term customer rates (in general on an annual or bi-annual basis) on these long term forecasts.

This is evident in the Company's inability to accurately predict the rate of return on assets over the past decade:[39]

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[38] PGE 2011 Form 10-k, pg 69, filed Feb. 24, 2012. Retrieved from: http://investors.portlandgeneral.com/secfiling.cfm?filingID=784977-12-33.
[39] *See* UE 262 - CUB Confidential Exhibit 202.

YEAR	Actual return on plan assets	Expected return on plan assets
1989	[redacted]	[redacted]
1990	[redacted]	[redacted]
1991	[redacted]	[redacted]
1992	[redacted]	[redacted]
1993	[redacted]	[redacted]
1994	[redacted]	[redacted]
1995	[redacted]	[redacted]
1996	[redacted]	[redacted]
1997	[redacted]	[redacted]
1998	[redacted]	[redacted]
1999	[redacted]	[redacted]
2000	[redacted]	[redacted]
2001	[redacted]	[redacted]
2002	[redacted]	[redacted]
2003	[redacted]	[redacted]
2004	[redacted]	[redacted]
2005	[redacted]	[redacted]
2006	[redacted]	[redacted]
2007	[redacted]	[redacted]
2008	[redacted]	[redacted]
2009	[redacted]	[redacted]

2010	[redacted]	[redacted]
2011	[redacted]	[redacted]
2012	[redacted]	[redacted]

In the years that returns have been greater than zero, the Company has earned, on average, a [redacted] return on its pension assets. However, going forward over the next several years, including the test year, the Company is forecasting returns at less than half of that. Given that recent statements by the Chairmen of the Federal Reserve[40] and multiple economic indicators imply continued growth, it is difficult to believe that the Company's predictions of asset returns at or below [redacted] are accurate in the short run. Why does this matter? A low predicted return on assets directly implies a higher current and near future FAS 87 expense, allowing the Company to forecast a higher basis for collecting in rates. That is, if the Company is overly modest in its predictions about asset returns, additional costs will artificially be imposed on ratepayers through inflated forecasts of FAS 87. CUB is not suggesting that it knows for certain the return on plan assets in the coming year. On the contrary, CUB is recognizing the inherent difficulty that the Company has had in forecasting returns, and will continue to have in the future.

If, for arguments' sake, we assume that the near future projections on pension plan asset returns are accurate, a very important concern arises. The ratepayers are paying more to invest in the pensioners' retirement plan than the plan is earning. That is, under the Company's current proposal, given that the Company is entitled to an <u>after-tax</u> return on equity of 9.75%,[41] and the predicted return is [redacted],[42] this means, that each

[40] http://www.federalreserve.gov/newsevents/press/monetary/20130731a.htm
[41] UE 262 – First Partial Stipulation.
[42] *See* UE 262 - CUB Confidential Exhibit 202, column "expected return on plan assets."

dollar that is made in cash contributions, and not offset by FAS 87 expense, must be reimbursed by the ratepayers, with the addition of before tax return on equity of approximately 13.75 cents, while only earning 7.5 cents. This immediately proves to be a very bad investment vehicle for the retirement plan funded by the ratepayers. This would be like funding your 401k, which earns a modest 7.5%, with your 13.75% credit card. It does not take a finance degree or actuarial experience to know that this is a bad investment. The ratepayers could do better for the pensioner by merely paying for the contribution on an annual basis, as it comes due.

X. CUB's Recommendations

A. PGE's Response to CUB Opening Testimony Recommendation

In Opening Testimony, CUB recommended that PGE move from ratemaking based on FAS 87 expense to ratemaking based on the Company's pension contributions using a 5 year balancing account to refund the pension contribution with a carrying charge. From the pension workshops in UM 1633, this is CUB's understanding of how the Idaho Public Utilities Commission regulates Idaho Power.

CUB continues to believe that this proposal makes sense. The pension contribution requires cash – it requires revenue. The FAS 87 expense, on the other hand, is an accrued expense that is important to investors to show the long term implications of changes in pension assets, and liabilities – but requires no cash outlay by the Company. If PGE's concern is that its pension fund has become underfunded under the PPA, forcing it to make a series of pension contributions, CUB's proposal would ensure that it would recover those contributions and earn a return on those contributions while being spread over the 5-year balancing account.

PGE response is that CUB's proposal would have a draconian effect on the Company:

> *The amounts in Accumulated Other Comprehensive Loss (AOCL) related to pension that PGE has recognized on its balance sheet would no longer be recoverable through the inclusion of F AS 87 expense costs in customer rates. Therefore, PGE would be required to write off the associated regulatory asset. If this sort of treatment were to occur in 2014 for example, it is estimated that PGE would incur a $316 million charge to the equity component of its balance sheet, which would change its capital structure from approximately 50% equity and 50% long-term debt to 42.5% equity and 57.5% long-term debt.*[43]

First, CUB notes that this option of using pension contributions as the basis of ratemaking is used in Idaho and was discussed at the workshops in UM 1633. In the workshops, the suggestion that it would cause a write-off associated with the Accumulated Other Comprehensive Loss/Gain was never mentioned. In fact, the relationship between pension accounting and the Accumulated Other Comprehensive Loss/Gain was not raised in the workshops.

Second, CUB notes that PGE did not explain why moving to ratemaking based on pension contributions would require such a write-off, other than to suggest that it is the Accumulated Other Accounting Loss/Gain that is actually being amortized by FAS 87 expense, not the prepaid asset.

CUB's proposal was designed to be fair. Between 1998 and 2012, shareholders contributed [redacted] in pension contributions, but customers overpaid FAS 87 expense by [redacted].[44] It is CUB's belief that ratepayers have slightly overcompensated shareholders for company contributions in the past, so if a system is in

[43] UE 262 - PGE/1800/Hager-Jaramillo/14.
[44] UE 262 - CUB Confidential Exhibit 102.

place that grants them 100% of future contributions, the pension problem should be solved. However, because the prepaid pension cost and the Accumulated Other Accounting Loss show up on PGE's books, this creates a write-off while the amount that customer have overpaid in FAS 87 does not.

CUB still believes that such a system would be better than the current FAS 87 approach. CUB Exhibit 202, which shows the pension information we have been able to accumulate going back to 1987, fails to identify a single year where the amount collected in rates under FAS 87 is the same as the actual FAS 87 amount.

CUB encourages PGE and the Commission to continue looking at ways to move to a pension ratemaking approach based on contributions rather than FAS 87 expense. There should be some way to transition to a system that will be more equitable to both customers and shareholders.

B. CUB's Alternate Proposal

Our alternative proposal is the same as it was in our Opening Testimony. Because FAS 87 cannot be forecasted accurately, and relying on PGE forecasts have led customers to overpay FAS 87 expense, ratemaking should be based on a rolling average of the last three years of FAS 87 actual expense. PGE accuses CUB of introducing "regulatory lag where none has existed since the introduction of FAS 87."[45] As CUB has previously stated, since FAS 87 was the basis of ratemaking, PGE's rates have never correctly forecasted it. CUB believes that accurate results which reflect regulatory lag are preferable in this case to forecasts that have no history of accuracy.

[45] UE 262 PGE/1800/Hager-Jaramillo/14.

CUB recommends that the Commission take the average of the last three years of FAS 87 expense (2010 2011, and 2012) and use this to forecast FAS 87 expenses in the test year. That amount would be [redacted].[46]

XI. Conclusion

In conclusion, CUB takes issue with a statement that the Company makes on the first page of its Rebuttal Testimony:

> *Pension is a complicated subject involving numerous laws, regulations, and standards*[47]

On the contrary, not pension, pension accounting and its interplay with pension funding is a complicated subject. This level of intricacy and uncertainty is not a reason to approve the Company requests. Instead, it is a reason to be diligent, in the search for the most honest, transparent and fair ratemaking treatment. CUB recognizes the complexity of pension accounting, and suggests alternative ratemaking treatment based on historical and current readily verifiable costs.

[46] UE 262 - CUB Confidential Exhibit 102.
[47] UE 262 - PGE/1800/Hager-Jaramillo/1, line 13.

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UE 262 - CUB Exhibit 202

CONFIDENTIAL

UE 262 – CERTIFICATE OF SERVICE

I hereby certify that, on this 6th day of August, 2013, I served the foregoing **REBUTTAL TESTIMONY OF THE CITIZENS' UTILITY BOARD OF OREGON** in docket UE 262 upon each party listed in the UE 262 PUC Service List by email and, where paper service is not waived, by U.S. mail, postage prepaid, and upon the Commission by email and by sending one original and five copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

(W denotes waiver of paper service)

(C denotes service of Confidential material authorized)

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