

Rocky Mountain Power
Docket No. 10-035-124
Witness: Bruce N. Williams

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF UTAH

ROCKY MOUNTAIN POWER

Rebuttal Testimony of Bruce N. Williams

Pension Costs

June 2011

1 **Q. Are you the same Bruce N. Williams that provided direct and rebuttal**
2 **testimony in this proceeding?**

3 A. Yes, I am. My previous testimony in this proceeding concerns capital structure
4 and costs of debt and preferred stock.

5 **Q. What is the purpose of this revenue requirement rebuttal testimony?**

6 A. The purpose of this revenue requirement rebuttal testimony is to respond to the
7 pension expense adjustments recommended by the Office of Consumer Services
8 (“OCS”) witness, Ms. Donna Ramas. The Company accepts certain of Ms.
9 Ramas’ adjustments to pension expense; however others are not supported by
10 facts and should not be accepted by the Commission. In addition, I provide an
11 update to the Company’s pension and post retirement welfare expense based on
12 known and measurable changes.

13 **Q. What level of pension and post retirement welfare expense did the Company**
14 **include in its direct testimony?**

15 A. The table below summarizes the Company’s initial filing in this docket:

| | |
|---|--------------|
| Pension and Post Retirement Welfare Expense (\$ millions) | |
| PacifiCorp Retirement Plan | \$27.80 |
| Local 57 | 13.85 |
| SERP | 2.50 |
| Post Retirement Welfare | <u>17.25</u> |
| | \$61.40 |

16 These amounts were determined by averaging projected Electric Operations
17 expense levels during 2011 and 2012 to match the test period of 12 months ending
18 June 30, 2012.

19 **Pension Expense**

20 **Q. What are the OCS’s recommendations on pension expense?**

21 A. Ms. Ramas proposes several adjustments to reduce gross PacifiCorp Retirement
22 Plan (“PRP”) and Local 57 expense by \$7.35 million from the Company’s initial
23 filing of \$41.65 million¹ to \$34.30 million.² The table below summarizes the
24 Company’s initial filing for those plans and what Ms. Ramas is recommending.

| Pension Expense (\$ millions) | | |
|-------------------------------|--------------|--------------|
| | Company | OCS |
| PacifiCorp Retirement Plan | \$27.80 | \$21.50 |
| Local 57 | <u>13.85</u> | <u>12.80</u> |
| Total | \$41.65 | \$34.30 |

25 **Q. Please summarize Ms. Ramas adjustments to PRP expense.**

26 A. Ms. Ramas proposes to reduce PRP expense to an annual amount of \$21.50
27 million by updating for actual 2011 expense and then making a further reduction
28 to expense by assuming an increase in the long-term rate of return on plan assets.

29 **Q. Does the Company agree with Ms. Ramas’ adjustments?**

30 A. The Company accepts her adjustment to reduce the 2011 PRP expense to the
31 actual amount of \$23.4³ million. As noted by Ms. Ramas, the 2011 PRP expense
32 was estimated by the Company’s actuaries during September 2010 as part of the
33 Company’s planning process. Subsequent to the filing of direct testimony in this
34 proceeding the Company now has actual 2011 PRP expense (Confidential Exhibit
35 RMP___(BNW-2R)). Updating for the \$23.4 million will provide a benefit to
36 customers and lower the proposed revenue requirement in this proceeding.

¹ Ramas direct testimony line 1543.

² Ramas direct testimony line 1809.

³ While \$24.0 million is the total 2011 PRP expense, the Company estimates that \$23.4 million is for Electric Operations.

37 However, as I will explain, Ms. Ramas' other proposed adjustment to
38 pension expense is not supported by evidence and should not be accepted by the
39 Commission.

40 **Q. Does the Company now also have an updated projection for 2012 PRP**
41 **expense?**

42 A. Yes. The Company has recently received from its actuary an updated projection
43 for 2012 PRP expense of \$19.2 million. The Company is proposing the use of this
44 updated projection in determining PRP expense during the test period.

45 **Q. Why did the actual 2011 PRP expense and projected 2012 PRP expense**
46 **decrease from the earlier projections?**

47 A. There are two main reasons why the actual 2011 and projected 2012 PRP
48 expenses are lower than earlier projected. First, the plan assets realized a return
49 during 2010 of 12.2 percent which was significantly more favorable than the
50 estimate of 2010 asset return utilized in determining the prior projections.

51 Second, as interest rates increased during the last quarter of 2010, a
52 corresponding increase occurred in the discount rate that was used to value plan
53 liabilities for 2011 expense purposes. A higher discount rate has the impact of
54 reducing the liabilities which, in turn, will decrease plan expense.

55 These same factors also resulted in reduced actual 2011 and projected
56 2012 post retirement welfare expense as I discuss later.

57 **Q. Please describe Ms. Ramas' proposed change to the assumed long term rate**
58 **of return.**

59 A. Ms. Ramas is proposing that the long term rate of return assumption on PRP

60 assets be increased by 0.25 percent from the 7.50 percent used by the Company to
61 a new assumed rate of 7.75 percent.

62 **Q. How did Ms. Ramas determine her proposed long-term rate of return?**

63 A. Ms. Ramas states that it is her opinion the long term rate of return should be
64 increased by 25 basis points to reflect a more appropriate and reasonable
65 projection.⁴ She attempts to support this opinion by referring to a 2009 survey of
66 what other companies had selected for their long term rate of return assumptions.

67 **Q. How did the Company determine the rate of 7.50 percent as the long term
68 rate of return for its pension assets?**

69 A. The Company performs a “bottom-up” analysis utilizing the asset allocation
70 targets for the investment portfolio and specific return for each asset class. The
71 return for each asset class, which is provided by an external investment
72 consultant, is then weighted by the amount of the portfolio allocated to that asset
73 class. The Company calculated that, based on its asset allocation targets and the
74 external consultants’ projected return for each asset class, the weighted average
75 return is 7.50 percent. Confidential Exhibit RMP___(BNW-3R) is a copy of the
76 workpapers that were used to develop this rate of return. In addition, the expected
77 long term rate of return was then reviewed and found acceptable by both the
78 Company’s actuary and independent external auditors.

⁴ Ramas direct testimony lines 1710 through 1713.

79 **Q. Would the Company's independent external auditors find it acceptable if the**
80 **Company selected its estimated long-term rate of return in a manner similar**
81 **to Ms. Ramas' approach?**

82 A. No. The Company's auditors would not accept the determination of the long-term
83 rate of return based on a comparison to what other companies and utilities are
84 doing. Generally accepted accounting principles in the United States of America
85 require that the expected long-term rate of return on plan assets reflect the average
86 rate of earnings expected on the funds invested for purposes of funding benefits,
87 and require consideration of returns being earned and expected to be earned by
88 such plan assets. During the annual financial statement audit, the Company's
89 independent external auditors request information supporting the Company's
90 calculation of the expected long-term rate of return. In determining the expected
91 long-term rate of return in this manner, the Company considers asset allocation
92 targets and asset class return expectations of the underlying portfolio of
93 investments.

94 **Q. Ms. Ramas states that a short history of actual return on pension assets**
95 **should at least be considered when determining the long-term rate of return.**
96 **Can you provide this information?**

97 A. Yes, the table below provides this information including the actual annual rate of
98 return.

| Year | Long Term Rate of Return Assumption | Actual PRP Return |
|--|-------------------------------------|-------------------|
| 2006 | 8.75%/8.5% | 12.04% |
| 2007 | 8.00% | 8.97% |
| 2008 | 7.75% | -23.26% |
| 2009 | 7.75% | 22.96% |
| 2010 | 7.75% | 12.18% |
| Annualized Return (assuming 8.75% in 2006) | | 8.00% |
| Annualized Return (assuming 8.50% in 2006) | | 5.26% |

99 For most years the pension assets earned returns greater than the
100 corresponding assumption. However, the impact of 2008 actual results is so
101 significant that the annualized actual return over this period of time is less than
102 the annualized assumed return. While it might be tempting to exclude 2008 actual
103 results as an “outlier” or “unlikely to occur again”, the fact is that it did occur and
104 over a long period of time similar results cannot simply be ruled out.

105 During the five years ending December 31, 2010, the pension assets
106 earned an annualized rate of return of 5.26 percent as compared to expected long-
107 term rate of return of 8.00 percent.⁵ If the Company were to consider using the
108 recent actual returns, such as suggested by Ms. Ramas, it would actually result in
109 a rate significantly lower than the 7.50 percent the Company selected with the
110 auditors concurrence.

⁵ The Company had two different long-term rate of return assumptions during 2006 due to the change in fiscal year from a March 31 end date to a calendar year basis. Had the 8.50 percent assumed rate of return been used to calculate the average assumed return over the time period ending December 31, 2010 the assumed annualized return would have declined to 7.95 percent. This result would not change the conclusion that assumed returns have been greater than actual results during this period of time.

111 **Q. How do the expense amounts proposed by the Company compare to the**
112 **Company's cash contributions?**

113 A. The Company is making cash contributions to the PacifiCorp Retirement Plan far
114 in excess of the expense to be recovered from customers in this proceeding. For
115 example, during the five years prior to 2012 the Company will have contributed
116 approximately \$224.4 million in excess of the aggregate amount of PRP expense.

| | PacifiCorp Retirement Plan (\$ millions) | | | | | |
|--------------------|--|------|------|-------|------|---------|
| | 2007 | 2008 | 2009 | 2010 | 2011 | Average |
| Expense | 51.5 | 26.2 | 23.3 | 20.9 | 24.0 | 29.2 |
| Cash Contributions | 75.8 | 65.6 | 49.6 | 112.8 | 66.5 | 74.1 |

117 The Company is not proposing to recover cash contributions rather than
118 expense, as is allowed by public utility commissions in certain other state
119 jurisdictions. Ultimately, over a long period of time, cumulative cash
120 contributions and expense will coincide.

121 **Q. Please summarize Ms. Ramas' proposed adjustment to Local 57 expense.**

122 A. Ms. Ramas is proposing to double the amount of the Company's projected
123 contributions during the six months ending June 30, 2011 of \$6.4 million for a
124 total of \$12.8 million.⁶

125 **Q. Does the Company agree with this adjustment?**

126 A. No. While no updated projections were available at the time Ms. Ramas was
127 developing her adjustments, the Company has now received updated projections
128 from the Local 57 plan actuary. These revised projections are included as Exhibit
129 RMP___(BNW-4R). As such, the Company proposes to use updated expected

⁶ Ramas direct testimony lines 1792 through 1795.

130 cash contributions to the Local 57 plan during the test period (\$18.5 million) less
131 amounts to be subsequently reimbursed by the union (\$5.9 million) for a total
132 expense of \$12.6 million. This reimbursement from the union is expected to begin
133 in 2015. I should note that this updated expense is approximately \$200,000 lower
134 than what Ms. Ramas recommended.

135 **Post Retirement Welfare Expense**

136 **Q. Is the Company proposing changes to the amount of post retirement welfare**
137 **(“PRW”) expense to be included in this proceeding?**

138 A. Yes, the Company now has actual 2011 total PRW expense and updated
139 projections for 2012 expense (Exhibit RMP___(BNW-2R)). For the same reasons
140 that the PRP expense has decreased from the earlier projected levels (i.e. more
141 favorable investment returns during 2010 and a higher discount rate used to value
142 plan liabilities) the PRW expense levels have also decreased.

143 The result of updating PRW expense is a reduction of approximately \$2.9
144 million which will provide a benefit to customers through lower proposed revenue
145 requirements in this proceeding.

146 **Q. Please summarize what level of expense for Pension and Post Retirement**
147 **Welfare that the Company is now including in this proceeding.**

148 A. The result of the previously described updates, as shown below, is gross pension
149 and post retirement welfare expense of \$50.85 million in this preceding which is a
150 reduction of \$10.55 million from the Company’s direct testimony.

| | | |
|---|-----------------------|------------------------|
| Pension and Post Retirement Welfare Expense | | |
| PacifiCorp Retirement Plan | | |
| Actual 2011 Expense | \$ 23,400,000 | |
| Updated Projection of 2012 Expense | <u>\$ 19,200,000</u> | |
| Average | | \$ 21,300,000 |
| Local 57 | | |
| Cash Contribution (July 2011 - June 2012) | \$ 18,500,000 | |
| Less expected union reimbursement | <u>\$ (5,900,000)</u> | |
| Net Local 57 Pension Expense | | \$12,600,000 |
| SERP | | |
| Actual 2011 Expense | \$ 2,600,000 | |
| Updated Projection of 2012 Expense | <u>\$ 2,600,000</u> | |
| Average | | \$ 2,600,000 |
| Post Retirement Welfare | | |
| Actual 2011 Expense | \$ 15,900,000 | |
| Updated Projection of 2012 Expense | <u>\$ 12,800,000</u> | |
| Average | | \$ 14,350,000 |
| Rebuttal Test Year Pension and PRW Expense | | \$ 50,850,000 |
| Filed Pension and PRW Expense | \$ 61,400,000 | |
| Rebuttal Pension and PRW Expense | <u>\$ 50,850,000</u> | |
| Incremental Change | | \$ (10,550,000) |

151 These amounts are included in Mr. Steven R. McDougal's updated revenue
152 requirement calculations as shown in Exhibit RMP___(SRM-2R), page 12.10.

153 **Q. Does this conclude your rebuttal testimony?**

154 A. Yes.