BEFORE THE WASHINGTON UTILITIES
AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-090704** **Docket No. UG-090705**

REPLY BRIEF OF THE FEDERAL EXECUTIVE AGENCIES

MARCH 2, 2010

Table of Contents

Table of Authorities

Orders of the Washington Utilities and Transportation Commission

I. Introduction

FEA's reply brief addresses these issues:

- PSE made a significant change in tax accounting for treatment of repairs for the tax year 2008 and forward; the impact of this known and measurable change in PSE's accumulated deferred income tax (ADIT) balance should be recognized for ratemaking purposes in this case as a reduction to rate base.
- Expense for PSE's defined benefit pension plan should be recognized for ratemaking purposes on the basis of a four-year average of the FAS 87 accruals recorded by PSE pursuant to Generally Accepted Accounting Principles through December 31, 2008
- PSE's expense for a Supplemental Executive Retirement Plan should be disallowed for ratemaking purposes

II. PSE made a significant change in tax accounting for treatment of repairs for the tax year 2008 and forward; the impact of this known and measurable change in PSE's accumulated deferred income tax (ADIT) balance should be recognized for ratemaking purposes in this case as a reduction to rate base.

Neither PSE nor Staff addressed the issue of the significant change in tax accounting treatment for repairs in their initial briefs, or the measurable impact of this known change, which affects PSE's balance of Accumulated Deferred Income Taxes (ADIT) as of December 31, 2008, the end of the test year.

Although Public Counsel did not address this issue in its direct and rebuttal testimony, Public Counsel states in its opening brief that it agrees with FEA's recommendation to reduce rate base for the increase in ADIT associated with adopting PSE's new method for accounting for repairs.[1]

PSE applied for a significant change in tax accounting during the 2008 test year to change its tax accounting method for the treatment of repairs that the Internal Revenue Service ("IRS") granted, which significantly increases ADIT and therefore reduces rate base.[2]

The repairs at issue occurred during the test year and the effects of the repairs under the changed tax accounting methodology are sufficiently known and measurable to be reported by the Company in its recently amended 2008 tax return.[3]

PSE has made other proforma adjustments that relate to other known and measurable changes, including changes which have occurred beyond the end of the test year ending December 31, 2008. The change in tax accounting for repairs made by PSE was approved by the IRS, and the quantification of this known and measurable adjustment affects PSE's ADIT balance for the test year. PSE's arguments that the

---

[1] Opening Brief of Public Counsel, p. 54.

[2] FEA Exhibit No. RCS-T, p. 11, Tr. Vol. VII at 479:9 – 481:9, 484:23 – 484:4 (Marcelia/PSE).

[3] Id. p. 492.

timing of IRS approval or its filing of an amended tax return for the 2008 tax year would somehow preclude this adjustment for ratemaking purposes is without merit. Accordingly, PSE's electric rate base and gas rate base should be reduced by the dollar amounts set forth at page 9 of FEA's Confidential Initial Brief.[4]

III. Expense for PSE's defined benefit pension plan should be recognized on the basis of a four-year average of the FAS 87 accruals

PSE's initial brief states that FEA's "results oriented" approach to funding pension costs is designed to ensure that the Company underrecovers its cost.[5] However, PSE later states in its brief that "actual cash payments or SFAS 87 calculated expense equal each other over time".[6]

PSE states that, "the utility industry continues to offer both defined benefit and defined contribution plans. Therefore, to be market competitive, PSE currently maintains both plans.'"[7] However, many other companies have discontinued defined benefit plans in favor of defined contribution plans.[8]

---

[4] FEA Initial Brief, p. 9.

[5] PSE Initial Brief, p. 2.

[6] Id. p. 47.

[7] Id. p. 45

[8] FEA Initial Brief, p. 12.

PSE also states that FEA asserts that the Company should solely utilize a defined contribution plan.[9] FEA did not state this and it is a misrepresentation of FEA's position. FEA's recommended allowance for PSE's defined benefit pension expense is based on a four-year average of the amounts that PSE recorded under Statement of Financial Accounting Standards 87 (FAS 87) pursuant to Generally Accepted Accounting Principles (GAAP). In other words, FEA has clearly used the FAS 87 GAAP results, for PSE's defined benefit pension plan for the four-year period through December 31, 2008, the end of the test year as the basis for the recommended expense allowance. Because of the notable and documented trend away from defined benefit pension plans, FEA also recommended that it might be time for PSE to re-evaluate whether it should continue to provide a defined benefit plan.[10] Public Counsel in its brief agrees with FEA's recommendation that it is time and appropriate for the Commission to revisit this issue in this docket.[11]

In its brief, the Company states that, "PSE's contributions have been reasonable and consistent with the Company's stated goals of returning the plan to a fully funded level with a reserve in case of volatility." However, PSE did not make any contributions in 1999-2002, 2004-2007.[12] In many of those years, PSE reported pension income, pursuant to FAS 87. One of the problems with using a utility's pension funding

---

[9] PSE Initial Brief, p. 45.

[10] FEA Initial Brief, p. 12.

[11] Opening Brief of Public Counsel, p. 44.

[12] PSE Initial Brief, p. 46.

contribution as the basis for the allowed expense for ratemaking purposes is that this allows management to manipulate the level of the allowed expense. The range of annual funding options for defined benefit pension plans in general, and for PSE's plan, in particular, is huge. The potential annual funding range for each year in the period 2006 through 2008 is set forth on page 17 of the confidential version of FEA's testimony (Exhibit No. RCS-1CT). Within the range for each year, the amount of funding is up to the discretion of management. This is not a reasonable standard for determining a ratemaking allowance.

PSE further states in its initial brief that, "FEA's proposal to retreat from the long-established Commission practice of using actual cash payments to determine rate recovery should be denied."[13] The Company also stated that:

> Due to dramatic stock market turmoil, PSE's retirement plan sustained significant losses during 2008. In light of these losses, PSE formalized a pension funding policy with the goal of establishing a "reasonable and consistent pattern of employer contribution".[14]

Continuing to utilize a cash basis for pension costs will not generate a consistent pattern of employer contributions as noted above. The range of employer contributions in any given year can be very broad. Basing this cost on a four-year average of the FAS 87 amounts appears to be consistent with Commission practice for other similar expenses such as Other Post Employment Benefits (OPEBs), which are recorded on an accrual basis under GAAP under FAS 108 similar to pension accounting under FAS 87.

---

[13] Id. p. 47.

[14] Id. p. 46.

Moreover, using a four-year average of FAS 87 amounts for PSE's defined benefit pensions would smooth out or "normalize" the expense allowance for ratemaking purposes.[15] Public Counsel in its brief supports FEA's use of a four-year average of actuarially determined Net Periodic Pension Costs for purposes of normalizing pension expense.[16]

In its initial brief, PSE states the following:

> Public Counsel and FEA argue that the 2009 funding amount should be removed because, among other things, the amount of contribution is subject to discretion by PSE's management.[17]

Contribution amounts are made at management discretion, which can be manipulated for purposes of deriving an expense allowance in a rate case.[18] As discussed above, a more appropriate standard for the ratemaking allowance is an average of the FAS 87 accruals.

PSE's pension request is based upon an average of four years ending September 2009, including estimates for contributions to be made outside the test year.[19] FEA used an average for the four-year period ending with 2008 because reliable FAS 87 accrual basis information for calendar 2009 was not available. FEA

---

15 FEA Initial Brief, p. 12.

16 Opening Brief of Public Counsel, pp. 43-44.

17 PSE Initial Brief, p. 46

18 FEA Exhibit No. RCS-T, p. 18.

19 Id. p. 14.

indicated that if PSE had been able to produce reliable FAS 87 accruals for calendar 2009, such as net periodic pension costs supported by an actuarial report, it would not be opposed to considering that information in an updated average.[20] However, PSE failed to provide actual FAS 87 accruals through September 30, 2009 that could be verified to an actuarial report.

In summary, as shown on Exhibit RCS-3, FEA recommends that PSE's requested amount of expense for its qualified pension plan be reduced by $3.607 million for electric and $1.9 million for gas, respectively. This increases PSE's net operating income for electric and gas by approximately $2.345 million and $1.266 million, respectively.

IV. PSE's expense for a Supplemental Executive Retirement Plan should be disallowed

FEA's and Public Counsel's recommendation that the SERP expense be disallowed for ratemaking purposes should be adopted. In PSE's initial brief, the Company states in part that, "This Commission has historically allowed SERP expenses in revenue requirements".[21] However, PSE's last rate case (UE-072300) was settled with regard to electric and gas revenue requirements issues and cannot be considered as precedent. The parties agreed in the prior rate case settlement document that:

---

[20] Id. p. 24.

[21] PSE Initial Brief, p. 47.

> No party shall represent that any of the facts, principles, methods or theories, employed by any party in arriving at the terms of this multi-party settlement agreement are precedents in any other proceeding.[22]

Furthermore, in PSE's 2006 GRC the subject of pension expenses was an uncontested issue and the issue of SERP expenses accordingly was not brought before the Commission other than through the summary of uncontested adjustments.[23]

Avista's 2005 (UE-050482), 2007 (UE-070804) and 2008 (UE-080416) rate cases were also settlements[24]. Avista did not include SERP costs in its most recent rate case (UE-090134)[25].

The Company's assertion that this Commission has historically allowed SERP expenses is unpersuasive, given the recent incidence of resolving revenue requirements issues through settlements that do not address the merits of individual issues and represent compromises for settlement purposes only. FEA urges this Commission to address the SERP issue on the merits of the record in the current PSE rate case.

In its initial brief, PSE also stated:

> This Commission …has stated: "The ultimate issue is whether total compensation is reasonable and provides benefits to ratepayers, not whether incentive compensation

---

22 Docket Nos. UE-072300 and UG-072301, Order No. 12, Appendix E: Partial Settlement Re: Electric and Natural Gas Revenue Requirements, pp. 9-10.

23 WUTC v. Puget Sound Energy Inc., UE-060266 and UG-060267, Order No. 8, pp. 40-41.

24 UE-050482, Order No. 5; UE-070804, Order No. 5; and UE-080416, Order No. 8.

25 UE-090134 Order No. 10.

> is pay in stock or whether compensation, particularly for executives, is similar to that of other comparable companies."[26]

The Company incorrectly attributes this statement to WUTC v. Puget Sound Energy, Inc. Order 04 at ¶128 (April, 17, 2006).[27] This Order was actually issued in PacifiCorp d/b/a Pacific Power & Light Company's 2005 general rate case.[28] In that case the Commission denied the company's proposed increase and did not adjust rates. The order simply addressed the contested adjustments involving matters of policy, accounting rules or theory.

The above statement made by the Commission in its April 17, 2006 order was contained in the discussion of the contested issue of PP&L's incentive compensation. SERP benefits are not a form of incentive compensation based on the achievement of specific goals. The SERP is a non-qualified plan and provides supplemental retirement benefits for select executives. Generally, SERPs are implemented for executives to provide retirement benefits that exceed limitations in qualified plans set by the Internal Revenue Service ("IRS"). Typically, SERPs provide for retirement benefits in excess of the limits placed by IRS regulations on pension plan calculations for salaries in excess of specified amounts.[29]

---

[26] PSE Initial Brief, p. 47, footnote omitted.

[27] Id. p. 47, footnote 222.

[28] UE-050684, Order No. 4, p. 48.

[29] FEA Exhibit No. RCS-T, pp. 25-26.

Interestingly, in its final order in PP&L's 2006 rate case, the Commission stated[30]:

> In recent years we have witnessed increasing attention to, and criticism of excessive levels of executive compensation and bloated severance packages. This criticism has come in part from prominent members of the business community who have served on corporate boards.[31] Moreover, the appropriate oversight committees of Congress have begun to investigate executive compensation policies and the role executive pay consultants play.[32]

PP&L's most recent rate case was partially settled prior to the intervening parties filing testimony and as a result this issue was not addressed.[33]

FEA recommends removing PSE's requested expense for the SERP, which is shown on FEA Exhibit (RCS-4). This adjustment reduces O&M expense by approximately $2.139 million for electric and $1.155 million for gas, respectively. This adjustment increases PSE's net operating income for electric and gas operations by approximately $1.390 million and $751,000, respectively.[34]

---

30 UE-061546, Order No. 8, p. 44.

31 Jason Zweig, a writer for MONEY magazine, reporting on Berkshire Hathaway's annual meeting in 2004, quotes Charles Munger, one of the group's top managers, as saying: "I would rather throw a viper down my shirtfront than hire a compensation consultant." This comment came on the heels of Warren Buffett's remarks that: "The typical large company has a compensation committee. "They don't look for Dobermans on that committee, they look for Chihuahuas………Chihuahuas that have been sedated." [footnote 114 in original text of Order No. 8]

32 See, e.g., Gretchen Morgenson's article entitled Panel to Look at Conflicts in Consulting in the May 11, 2007, electronic edition of the Sarasota Herald-Tribune. [footnote 115 in original text of Order No. 8]

33 Docket No. UE-090205, Order No. 10

34 FEA Initial Brief, p. 13.

Public Counsel has also recommended that the Commission remove PSE's SERP expense in its entirety.[35] FEA agrees with PC and all of the reasons it provides for removing SERP.

V. Conclusion

For the reasons set forth above, FEA urges this Commission to adopt its recommendations on the matters addressed in its testimony and briefs.

Respectfully submitted,

NORMAN J. FURUTA
Associate Counsel
(Regulatory Law)
Federal Executive Agencies
1455 Market Street, Suite 1744
San Francisco, CA 94103-1399
TEL: (415) 503-6994
FAX: (415) 503-6688
e-mail: norman.furuta@navy.mil

[35] Opening Brief of Public Counsel, pp. 44-45.