

**EXHIBIT NO. \_\_\_(TMH-1T)**  
**DOCKET NO. UE-09\_\_\_/UG-09\_\_\_**  
**2009 PSE GENERAL RATE CASE**  
**WITNESS: THOMAS M. HUNT**

**BEFORE THE**  
**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**PUGET SOUND ENERGY, INC.,**

**Respondent.**

**Docket No. UE-09\_\_\_**  
**Docket No. UG-09\_\_\_**

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF  
THOMAS M. HUNT  
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**MAY 8, 2009**

**PUGET SOUND ENERGY, INC.**

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF  
THOMAS M. HUNT**

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1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF**  
3 **THOMAS M. HUNT**

4 **I. INTRODUCTION**

5 **Q. Please state your name, business address and present position with Puget**  
6 **Sound Energy, Inc.**

7 A. My name is Thomas (Tom) M. Hunt. My business address is 10885 NE 4th Street,  
8 P.O. Box 97034, Bellevue, Washington 98009-9734. I am the Director of  
9 Compensation and Benefits for Puget Sound Energy, Inc. (“PSE” or the  
10 “Company”).

11 **Q. What is your educational and professional experience?**

12 A. Exhibit No. \_\_\_\_ (TMH-2) describes my educational and professional experience.

13 **Q. What are your duties as Director of Compensation and Benefits?**

14 A. I have the overall management responsibility for the functions of compensation,  
15 benefits and human resources reporting. I manage employees who analyze, design  
16 and administer the following programs for PSE employees and retirees:

- 17 • Compensation for non-bargaining unit represented  
18 employees;

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- Employee health and welfare benefits for all active employees (and retiree medical programs for retirees);
- Retirement plans (Pension and 401k); and
- Short-term and long-term disability programs, ergonomics, job modifications and Workers Compensation.

I personally analyze executive compensation programs and provide updates to the Compensation and Leadership Development Committee of the PSE Board of Directors at their regular meetings. I report directly to the Vice President of Human Resources.

**Q. Please summarize your testimony.**

A. My testimony describes PSE’s compensation and benefits programs, including the Goals and Incentive Plan, and demonstrates how these programs are competitive in the market and ultimately benefit the Company’s customers by improving the Company’s ability to hire and retain experienced employees. Even in today’s difficult economy, PSE finds a shortage of skilled employees in many areas. PSE seeks to provide a competitive total compensation program to attract and retain talented employees in the competitive utility hiring environment, while carefully managing its costs. I also discuss the time needed to hire and train a new employee, which emphasizes the importance of retaining experienced employees.

My testimony includes a description of the compensation programs for Company executives and explains how the same compensation philosophy that applies to all

1 employees also applies to Company executives, based on the market data for utility  
2 executives. Included in the executive compensation testimony is a summary of the  
3 portion of executive compensation paid by customers and the portion paid by  
4 investors.

5 Finally, my testimony reviews PSE's benefit programs, including the retirement  
6 program and recent legislative and market changes that affect pension plans.  
7 Employee benefits are important components of the Company's total compensation  
8 strategy to keep overall levels competitive with the market and drive performance,  
9 while at the same time controlling costs.

10 **II. PSE DESIGNS AND ADMINISTERS ITS COMPENSATION**  
11 **AND BENEFIT PROGRAMS TO RECRUIT AND RETAIN A**  
12 **SKILLED WORKFORCE THAT PROVIDES QUALITY, COST-**  
13 **EFFECTIVE SERVICE IN A COMPETITIVE UTILITY LABOR**  
14 **MARKET**

15 **A. Compensation and Training Philosophy**

16 **Q. Please describe the Company's compensation philosophy.**

17 A. The Company has a two-part compensation philosophy: (1) pay competitively  
18 compared to the utility market; and (2) pay-for-performance. This two-part  
19 compensation philosophy is designed to attract new quality employees and motivate  
20 our employees to stay at the Company to develop and maintain their experience in  
21 operating the utility. This provides business continuity and maintains a high quality

1 of work. Paying for performance is important in directing higher rewards to the  
2 strongest performers, enhancing productivity and effectiveness and motivating  
3 quality employees to stay.

4 **Q. How does the Company determine whether its salary structure is competitive**  
5 **as compared to others in the industry?**

6 A. PSE participates in numerous confidential salary surveys provided by third-party  
7 consulting firms, which compare PSE's pay programs—both base salary and  
8 variable pay—to other utility companies in our labor markets. PSE's annual  
9 budgeted salary increase for non-represented employees was 3.5% in 2008. Exhibit  
10 No. \_\_\_(TMH-3C) shows that PSE's budget was at the median or slightly below the  
11 median for regional companies and for the utility industry. The 2008 actual salary  
12 increase was 3.41%, compared to an expected market range between 3.5% and  
13 4.2%. Future PSE salary increases are expected to match the median in the market  
14 so that PSE can maintain competitive salaries. For example, the merit increase  
15 budget for 2009 is 3.5% which is at or near the median of other utilities and  
16 regional companies as shown in the "Forecasted 2009" column of Exhibit No.  
17 \_\_\_(TMH-3C).

18 **Q. How does the Company implement its pay-for-performance philosophy?**

19 A. PSE implements pay-for-performance through its merit increases (for non-  
20 represented employees) and through the Goals and Incentive Plan, which is

1 described in a later section of my testimony. PSE's salary grade structure allows  
2 managers to set base salaries of non-represented employees within the full range of  
3 labor-market rates. An employee's position within the pay range (Position in  
4 Range ("PIR")) depends upon several factors including experience, skill,  
5 knowledge and performance. PSE managers and supervisors reinforce pay-for-  
6 performance by rating an employee's performance and using the employee's PIR to  
7 determine merit salary increases.

8 **Q. How are union wage increases determined?**

9 A. Union wage increases are governed by contract between the Company and the  
10 unions. Effective April 1, 2008, the International Brotherhood of Electrical  
11 Workers ("IBEW") union employees had a contractual wage increase of 3.25%,  
12 with a scheduled wage increase of 3.25% effective April 1, 2009. The United  
13 Association of Journeymen and Apprentices of the Plumbing and Pipefitting  
14 Industry of the United State and Canada ("UA") union employees had contractual  
15 wage increases of 3.00% effective October 1, 2008, and will have an increase of  
16 3.00% effective October 1, 2009. The current IBEW and UA contracts expire in  
17 2010, and the Company plans to negotiate future wage increases and other contract  
18 terms prior to each contract's expiration.

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1 **Q. Has the economic downturn modified PSE's compensation program as it**  
2 **competes for qualified employees?**

3 A. Yes. PSE officers will not receive a salary increase for 2009. Base compensation  
4 for officers is being kept at 2008 levels to recognize the economic downturn. Other  
5 employees received merit-based salary increases effective March 1, 2009. PSE  
6 recognizes that the economic downturn has led to increased unemployment and  
7 caused some companies to freeze all salaries or provide lower increases. Except as  
8 noted above, this is not the case with PSE or other utilities to date, because the  
9 utility industry continues to face labor and managerial shortages that challenge the  
10 utilities' ability to lead key business functions and staff significant infrastructure  
11 projects such as the ones discussed by Ms. Harris and Mr. Valdman in their prefiled  
12 direct testimonies. For example, based on a review of 63 regional utility on-line  
13 websites, on February 26, 2009 there were 292 job postings, including PSE's. The  
14 open jobs included 67 at PacifiCorp, 55 at the Bonneville Power Administration, 37  
15 at PSE, 15 at Seattle City Light and 13 at Tacoma Light. In order to fill needed  
16 skill sets and remain competitive in hiring, most utilities – as well as PSE – have  
17 not changed their merit plan programs or instituted overall salary freezes.

18 **Q. Is PSE actively recruiting employees?**

19 A. Yes. PSE hired 478 new employees in 2008 and 425 in 2007. The Company has  
20 consistently needed to recruit employees to fill positions for those who have retired



1 or left PSE, as well as adding employees in areas such as Operations, Energy  
2 Production, and Customer Service to deliver on customer reliability and new  
3 generation resources.

4 As I mentioned in the Company's last general rate case, PSE is faced with an aging  
5 workforce and a diminishing supply of skilled utility workers. There are current  
6 shortages projected in skilled utility workers across the United States as retirements  
7 within the next five years could exceed 50%. Areas of highest concern include  
8 skilled craft workers (journey-level workers in electric transmission and  
9 distribution), engineering, accounting/finance, regulatory analysis, project  
10 management, and generation management. PSE and its customers benefit when the  
11 Company can retain skilled utility workers with long tenure and  
12 extensive knowledge of its systems.

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1 The table below shows the growth in headcount at PSE, and highlights how the  
2 business areas such as operations and energy resources have grown:

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	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>Change 2006 to 2008 (#)</b>	<b>Change 2006 to 2008 (%)</b>
Operations	1,105	1,211	1,265	+ 160	+ 14.5%
Customer Service	581	552	629	+ 48	+ 8.3%
Information Technology	152	178	201	+ 49	+ 32.2%
Business Administration	207	222	243	+ 36	+ 17.4%
Energy Resources	325	383	454	+ 129	+ 39.7%
<b>TOTAL</b>	<b>2,392</b>	<b>2,573</b>	<b>2,817</b>	<b>+ 425</b>	<b>+ 17.8%</b>

4 **Q. Does PSE have a process for reviewing the number of employees needed within**  
5 **each department?**

6 A. Yes. When a position becomes vacant, a hiring manager is encouraged to  
7 determine if the vacancy is an opportunity to make changes within the department  
8 or find an alternative way to accomplish the tasks utilizing the remaining  
9 employees. A step-by-step process, including a checklist, reference to relevant  
10 corporate policies, and a list of questions to help facilitate the decision to "fill or  
11 not" are utilized. If the manager decides to move forward with filling the vacancy, a  
12 Requisition Approval Form ("RAF") must be prepared, with the rationale for filling  
13 the opening and an approved job description. The business unit's vice president

1 must approve the RAF before the position can be filled.

2 **Q. How does the Company make sure that it has enough employees to meet its**  
3 **service commitments?**

4 A. Each department prepares an annual budget with the forecast staffing and other  
5 costs needed to complete the department's operational goals for the next year. The  
6 budget amounts are reviewed by each officer, by the PSE Budget Department, and  
7 by PSE's senior officers, before being recommended to the Board of Directors who  
8 approve the budget. If a department's approved budget includes additional staff  
9 positions, the manager of the new position completes a RAF document, as  
10 described above, obtains approval from the vice president responsible for the area,  
11 and works with PSE Staffing and Diversity to fill the position. If a department's  
12 approved budget is lower than the current level of costs, employee positions may be  
13 eliminated, either through employee transfers to other parts of PSE, through  
14 attrition (i.e., not filling open positions) or through layoff.

15 **Q. What is the typical length of time needed to hire and train a new employee?**

16 A. It is very common for the hiring process to take in excess of 60 days to fill a routine  
17 opening. Select positions that require particular experience or expertise can take  
18 several months longer. Once hired, the training of a new employee can range from  
19 a few months for clerical jobs to a few years for specialized positions. For  
20 example, a new employee hired into a Wire Apprentice program spends four years

1 before reaching the Wireman level. An employee hired into System Operations  
2 spends two-and-a-half years in a System Operator Training Program before  
3 qualifying as a System Operator. Employees entering into Meter Apprentice,  
4 Combined Turbine and Hydro Apprentice programs spend four years before  
5 completing their training. A newly graduated Bachelor of Science engineer  
6 typically enters the Engineer in Training Program for one year, with rotations to  
7 learn various parts of the organization, before moving into a specific job where on  
8 the job training continues. The progression to an experienced utility engineer  
9 position such as PSE's Senior Engineer role can take four to five years. In addition  
10 to these examples, there are significant training periods for Accountants, Financial  
11 Analysts, Regulatory Analysts, and other professional positions to learn the specific  
12 regulations and reporting requirements unique to the utility industry.

13 **B. Executive Compensation**

14 **Q. How are executive salaries determined?**

15 A. The Company recognizes that there is a labor market for executive employees, just  
16 as all employees are part of the general labor market. To attract and retain  
17 executives (PSE's officers and employee directors), PSE must first understand this  
18 labor market and then offer a compensation package that is competitive. The  
19 Company has surveyed this labor market and found that PSE executive pay levels  
20 are market-competitive at an overall level as well as within the programs designed

1 to deliver executive pay.

2 **Q. What are the elements of the executive labor market?**

3 A. Executives have greater responsibility and accountability than other employees, and  
4 in return have a different structure of compensation, including more pay at risk and  
5 higher levels of compensation opportunity. These pay-for-performance  
6 components link executive pay to multiple year performance, because executive  
7 leadership impacts the Company in the current year and future years. Additionally,  
8 special reporting requirements and tax regulations apply to executives. The  
9 executive compensation structure primarily varies from the compensation structure  
10 for other employees by having: (1) more cash incentive pay at risk, determined by  
11 market survey levels; (2) a long-term incentive plan (“LTIP”) tied to multiple year  
12 company performance; and (3) more salary charged below the line because  
13 executives perform some work directly related to equity investor tasks. The result  
14 of these programs is that executive compensation can be higher than target when  
15 personal and Company performance is above target levels, but can be significantly  
16 lower when performance is below target.

17 The executive compensation structure also usually includes a Change in Control  
18 (“CIC”) plan or employment agreement for officers and executive retirement  
19 programs, such as the Supplemental Executive Retirement Plan (“SERP”) and  
20 Deferred Compensation Plan (“DCP”), which will be discussed in more detail

1 below.

2 **Q. How does the Company determine the salary structure for officers?**

3 A. Officers' salaries are administered on an individual position basis and reviewed by  
4 the Compensation and Leadership Development Committee of the Board. The  
5 Company uses a market comparison group of similarly sized utility companies, and  
6 follows a pay-for-performance philosophy for executives to determine competitive  
7 salaries. The Company provided extensive information about its executive  
8 compensation program in its 2008 SEC 10-K filing, following the detailed  
9 Securities and Exchange Commission guidelines for disclosure. Please see Exhibit  
10 No. \_\_\_(TMH-4) for an excerpt from the Company's 2008 10-K filing disclosure  
11 on executive pay.

12 **Q. How does compensation of PSE's President and Chief Executive Officer**  
13 **compare with other executives in similar positions?**

14 A. Please see Exhibit No. \_\_\_(TMH-5C) for the market data used in 2007 by the  
15 Compensation and Leadership Development Committee of the Board in evaluating  
16 the 2008 pay program for PSE's President and Chief Executive Officer ("CEO"),  
17 Mr. Stephen Reynolds. The graph shows four columns of data. The left column  
18 outlines Mr. Reynolds' 2007 base and target compensation. The other three  
19 columns show market data for actual base salary and target incentive compensation  
20 for a "Comparator Group" of similarly sized utilities for the 25<sup>th</sup>, Median (50<sup>th</sup>), and

1 75<sup>th</sup> percentile values. Please see Exhibit \_\_\_(TMH-4), page 3 for a listing of this  
2 Comparator Group. Each column sets forth the amount of compensation allocated  
3 to base salary, annual incentive pay, and LTIP compensation. This graph confirms  
4 that the pay program for PSE's President and CEO is competitive with the market.  
5 The graph also illustrates that LTIP is the single largest portion of the pay package,  
6 and LTIP is funded by the investors and not by the customers.

7 **Q. What components of executive compensation are paid by customers?**

8 A. The Company includes in operating costs executive compensation expenses that are  
9 related to utility operation and management for the main compensation programs,  
10 i.e., base salary, overheads for health and welfare benefits, annual incentives and  
11 retirement benefits.

12 **Q. What benefits do customers receive from executive compensation?**

13 A. Executive leadership provides guidance for utility's operations, and appropriate  
14 compensation is required to retain the leadership services of quality executives.  
15 Customers benefit from good utility leadership by having effectively and efficiently  
16 managed Company operations. Company executives also interact with customers  
17 and community representatives, providing increased understanding of the industry  
18 and the impacts that customers can have on its operations. This interaction  
19 provides a direct channel for customers to hold the Company accountable on  
20 operational performance issues such as reliability and cost.

1 **Q. What components of executive compensation are paid by the investors?**

2 A. The single largest component of CEO compensation is paid from the Company's  
3 multi-year incentive plan, the LTIP. For other officers and directors, the LTIP is  
4 also a significant part of compensation, and the largest single element of incentive  
5 compensation. This plan is a market-competitive pay program that is fully funded  
6 by the Company's investors. In the Company's 2008 SEC 10-K filing, the  
7 importance of the LTIP was highlighted: "Long-term performance-based incentives  
8 are designed to comprise the largest portion of each executive's incentive pay." *See*  
9 Exhibit No. \_\_\_\_ (TMH-4), page 3.

10 **Q. Have executive compensation programs changed as a result of the merger of**  
11 **Puget Energy and the investor consortium?**

12 A. The main compensation programs for executives or for other employees remain in  
13 place after the Company's change in ownership. Programs that included stock,  
14 such as the LTIP, are being revised to use performance measures that do not rely on  
15 stock. For the LTIP, the program will be a cash-based plan with a three-year grant  
16 cycle, measured on the Service Quality Indices ("SQIs") and a financial measure  
17 replacing a stock-based measure. This cost will be treated in the same manner as  
18 LTIP has previously been treated by the Company, i.e., funded by investors not  
19 customers.



1 **C. Employee Benefits**

2 **Q. Please describe the Company's employee benefit plans.**

3 A. The Company offers a "cafeteria" benefit plan for employees. Employees have  
4 several choices as to type of medical plan, dental plan, life insurance, etc., so that  
5 they can determine the best fit for their situations. The Company allots a yearly  
6 benefit amount to each employee that will cover the cost of basic benefits for  
7 employee-only coverage. Employees who want more benefits than the allotment,  
8 or who elect family coverage, contribute some of their salary to cover the additional  
9 cost.

10 **Q. How does PSE's overall health cost per employee compare with others in the**  
11 **industry?**

12 A. Please see Exhibit No. \_\_\_(TMH-6C) which demonstrates that PSE's average total  
13 health benefit cost per employee is competitive with other utilities. Further, PSE's  
14 rate of increase from 2007 to 2008 was lower than that of other comparable utilities.

15 **Q. What has the Company done to manage the cost of employee health benefits?**

16 A. Rising benefits cost is a challenge facing all employers. PSE manages these rising  
17 costs with a philosophy that combines extensive employee choice and cost sharing.  
18 The Company's medical plan is designed to involve employees and communicate  
19 the full costs of the programs that they are selecting. As mentioned above,

1 employees share in the costs of their coverage if they elect more than the standard  
2 features. In addition to helping control Company medical costs, this design helps  
3 employees become informed health care consumers. PSE also provides  
4 opportunities for its employees to fully utilize Internal Revenue Service ("IRS")  
5 approved tax saving plans, such as health care spending accounts and pre-tax  
6 benefit deductions.

7 To further contain costs, while meeting employees' needs for health care, the  
8 Company's health care plan providers offer 24-hour registered nurse hotlines,  
9 health care utilization review, case management, and wellness benefits such as  
10 health risk assessments, health coaching, physical examinations and cancer  
11 screening exams for early detection and prevention. Since 2005, PSE also has  
12 offered voluntary employee fitness programs through alliances and discounts with  
13 fitness organizations. PSE plans to continue to emphasize preventative medicine  
14 and wellness as a way to improve employee health and productivity and control  
15 costs.

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19 **D. Retirement Benefits**

1 **Q. What retirement benefit programs does the Company provide?**

2 A. PSE recognizes that retirement programs are crucial to attracting and retaining a  
3 skilled workforce. For active employees, PSE offers a defined benefit pension plan  
4 and a 401(k) employee savings plan. The 401(k) plan provides tax-deferred savings  
5 with the Company providing matching dollars for the first 6% invested by the  
6 employee (except for IBEW-represented employees). The Company's matching  
7 feature encourages employee participation in the plan and provides incentive for  
8 employees to maximize contributions to take full advantage of the Company match.  
9 The PSE pension plan is a defined benefit plan with one formula for non-bargaining  
10 and UA represented employees and one formula for IBEW-represented employees.  
11 The funding of the PSE pension plan is described in more detail in the next section.  
12  
13 Additionally, as noted above, PSE offers a SERP and a DCP for certain executive  
14 employees. SERP and DCP offer something for both executives and employers.  
15 For executive employees, these programs allow retirement replacement incomes  
16 comparable to non-executives. For employers, SERP and DCP facilitate hiring  
17 mid-career executives and help retain executives. Because traditional retirement  
18 plans accrue more value at the end of an employee's career, executives would lose  
19 retirement plan value if they left mid-career and did not have a SERP at the new  
20 employer. The retention aspect of SERP is due to its five-year vesting period, so an  
21 executive has incentive to remain at least five years. The SERP formula maximum  
of 50% of eligible pay is reached after 15 years of service, so after five years,

1 executives are also incented to stay until 15 years of service. The final retention  
2 element of the SERP is that its early benefit commencement at age 55 is only  
3 available to employees who stay with PSE until age 55. Vested participants who  
4 leave prior to age 55 must wait until age 62 to begin receiving their benefit.

5 **Q. Does PSE offer medical insurance plans for retired employees?**

6 A. Yes. PSE offers enrollment in group medical insurance plans for retired employees  
7 who join the plan immediately after retirement. The Company does not subsidize  
8 retiree medical premiums except for some IBEW-represented positions and  
9 employees who retired long ago. Among active employees, only some IBEW-  
10 represented employees who had five or more years of service as of June 20, 2007  
11 will receive a Company contribution towards the PSE retiree medical premiums in  
12 the amount of \$6 per month for each year of service when they retire.

13 **III. HOW THE MARKET IMPACTS PSE'S PENSION PLAN AND**  
14 **ITS FUNDING**

15 **Q. How does the performance of the financial markets impact pension plans**  
16 **generally?**

17 A. Pension plans receive company contributions into a trust to pay future retiree  
18 benefits and invest the contributions until payment is needed. Pension plan funding  
19 is regulated by federal pension laws, accounting standards, and IRS rules that

1 require a certain level of plan funding be maintained and that also establish a range  
2 of minimum required and maximum allowed contributions. When pension plan  
3 investments have positive returns that exceed forecast gains, the plan's funding  
4 level improves and the need for company contributions is reduced or eliminated.  
5 Conversely, if pension plan investments have negative returns, the losses reduce the  
6 plan's funding level and increase the need for company contributions. As such, the  
7 performance of the financial markets has a direct impact on a pension plan's gains  
8 and losses.

9 **Q. What has been the funding level of PSE's pension plan and has PSE made**  
10 **contributions?**

11 A. During most recent years, the PSE pension plan has had good investment returns,  
12 which have kept the plan's funding level greater than 100% and meant that no  
13 funding was required. The confidential table at Exhibit No. \_\_\_(TMH-7C) shows  
14 the funding of the plan since 1999. From 1999 through 2002, no contributions were  
15 required under pension plan funding rules and the funded status of the plan. In  
16 2003, a contribution was made after the plan's funding level dropped. Then again  
17 from 2004 until mid-2008, the plan's funding level was good, with assets exceeding  
18 liabilities so the Company did not make any contributions. By mid-2008, the global  
19 economy saw a steep drop in stock markets and the plan's funding level dropped  
20 below fully funded. The Company made a contribution of \$24.5 million dollars in  
21 December 2008.

1 **Q. Is PSE's pension fully funded as of December 31, 2008?**

2 A. No. The decrease in pension plan assets during 2008 means that the pension plan's  
3 assets no longer exceed the plan's expected obligations, therefore, the plan is no  
4 longer fully funded. As reported in the Company's SEC Form 10K, the PSE  
5 pension plan has obligations of \$460.6 million and assets valued at \$392.9 million,  
6 for a funding deficit of \$67.7 million. Of note, this funding gap would have been  
7 even larger if the Company had not contributed \$24.5 million in December 2008.

8 **Q. What is the Pension Protection Act and what impact does it have on PSE's**  
9 **pension plan?**

10 A. The Pension Protection Act of 2006 (the "Act") is a comprehensive reform of  
11 pension laws that was passed in August 2006. It established new funding  
12 requirements for defined benefit pension plans, and includes reforms that affect  
13 defined contribution plans and deferred compensation plans. The most significant  
14 impact that the Act has on PSE's pension plan results from the newly established  
15 funding requirements. These requirements establish new rules for determining  
16 whether the plan is fully funded; rules to determine the contribution needed to fund  
17 the benefits that plan participants will earn in the current year; and rules to  
18 determine the contributions to the plan if it is not fully funded.  
19 The Act shortens the time in which employers have to fund any under-funded  
20 liabilities. Prior to the Act, plan sponsors were not required to fund liabilities to

1 100%. When it is fully phased in, the Act will require plan funding to be equal to  
2 100% of the plan's liabilities and any funding gaps will generally need to be  
3 partially addressed each year and corrected within six years. In addition, the Act  
4 raises the level of required minimum contributions. This required amount is now  
5 based on the plan's target normal cost which is a measurement of the present value  
6 of all benefits that plan participants will accrue during the year.

7 **Q. What is PSE doing to address the level of pension funding?**

8 A. As mentioned previously, PSE made a \$24.5 million contribution to the retirement  
9 plan in December 2008 and expects to make ongoing contributions until the plan is  
10 fully funded. PSE has developed a pension funding guideline and will contribute at  
11 least \$18.4 million during 2009, including \$6 million which was contributed to the  
12 plan on April 6, 2009.

13 **Q. When is the PSE pension plan expected to return to full funding?**

14 A. According to an actuarial forecast of future anticipated contributions and using  
15 investment return assumptions, the plan is expected to reach full funding in five to  
16 six years. However, if actual market rates of return are lower than estimates, full  
17 funding would occur over a longer period of time. PSE is dedicated to fully  
18 funding the plan and appropriately investing pension funds.

19 **Q. What steps does PSE take to appropriately invest pension funds?**

1 A. PSE has a professional investment advisor and a committee of officer and director-  
2 level employees who provide oversight of the pension plan investments, including  
3 review of investment allocation and fund manager performance compared to  
4 benchmarks. Annually, the committee of officer and director-level employees gives  
5 a report on the pension plan to the Compensation and Leadership Development  
6 Committee of the Board. In addition, PSE's pension plan is professionally  
7 managed by an independent investment advisor and has a diversified group of  
8 assets.

9 **IV. PSE'S GOALS AND INCENTIVE PLAN MOTIVATES**  
10 **EMPLOYEES TO HELP THE COMPANY OPERATE**  
11 **EFFICIENTLY AND MEET SERVICE QUALITY GOALS**

12 **Q. Please describe PSE's Goals and Incentive Plan.**

13 A. PSE's Goals and Incentive Plan provides all employees with the opportunity for  
14 incentive payment based on Company, team and individual performance. As part  
15 of PSE's pay-for-performance philosophy, the Goals and Incentive Plan helps retain  
16 and motivate employees. The program is a variable incentive plan whereby  
17 employees are eligible to receive incentive pay if the Company, team and individual  
18 goals are achieved, and places employees' pay at risk if these goals are not met. As  
19 noted in PSE's previous rate case, the incentive program continues to emphasize  
20 performance goals that benefit customers. Please see Exhibit No. \_\_\_\_ (TMH-8) for  
21 PSE's 2008 Goals and Incentive Plan.



1 **Q. How does PSE's Goals and Incentive Plan benefit customers?**

2 A. PSE's Goals and Incentive Plan provides three distinct benefits to customers. First,  
3 the plan focuses work groups and individuals on the key objectives of the  
4 Company, including safety, reliability, customer service and operational efficiency.  
5 Customer service, safety, reliability and service quality goals directly benefit  
6 customers, and overall operational efficiency translates to lower rates for  
7 customers.

8 Second, the Goals and Incentive Plan slows the base wage growth that would occur  
9 in a compensation system with base salaries only. The Company's current plan  
10 involves significant pay at risk for all employees. The most direct benefit to  
11 customers from the structure of the Goals and Incentive Plan is that total  
12 compensation is dependent on the Company achieving its strategic objectives.

13 Third, the Goals and Incentives Plan is part of a comprehensive compensation and  
14 benefits package provided to employees that makes PSE an attractive employer to  
15 skilled, experienced talent in the market place. Customers directly benefit from the  
16 contributions of a strong workforce that provides high-quality and efficient service.

17 **Q. How does PSE establish the incentive goals for its employees?**

18 A. PSE's strategic objectives are established through a long-range plan approved by  
19 the Board of Directors. From the long-range plan, annual objectives relating to

1 service quality and operational efficiency are set by the officers and approved by  
2 the Board of Directors each year. Team and individual goals are then formulated to  
3 reflect the Company-wide objectives. All employees are aligned to the Company's  
4 annual goals as well as to their individual and team goals. They are encouraged to  
5 contribute ideas – such as customer service, safety and cost containment ideas – and  
6 efforts to help achieve these goals.

7 **Q. Does PSE's incentive plan apply to PSE employees who are subject to collective**  
8 **bargaining agreements?**

9 A. Yes. Represented employees are subject to the same incentive plan terms as non-  
10 represented employees, although with a lower incentive opportunity as negotiated  
11 by the Company and the unions representing PSE's employees. Further, with  
12 represented employees, the goals are team-based instead of individual-based.

13 **Q. How is PSE's incentive plan structured at the corporate executive level?**

14 A. All employees, including directors and officers, participate in the Goals and  
15 Incentive Plan and are linked to the PSE goals. Every non-represented employee  
16 has a target incentive opportunity, based on market competitive pay levels, and  
17 expressed as a percentage of his or her base salary. Officers have higher incentive  
18 targets as a percentage of salary than other employees, reflecting the market levels  
19 of incentive pay, and therefore have more pay at risk.

1 **Q. What was the threshold requirement for a payout under the Goals and**  
2 **Incentive Plan in 2008?**

3 A. For any incentive payment to be possible, two threshold requirements must be met:  
4 First, PSE's earnings per share ("EPS") must exceed the "trigger" level (\$1.14/share  
5 in 2008). As discussed below, as a result of the merger EPS will be replaced with a  
6 new performance measure to help the Company meet its financial budget. Second,  
7 PSE must meet or exceed its required performance on at least five of 11 of the SQI  
8 goals. In order for the 2008 Goals and Incentive Plan payment to be 100% of target  
9 level, PSE's EPS must be \$1.20/share (the middle of the Company's guidance range  
10 to analysts) and SQI performance must be met on 10 out of 11 goals. Please see  
11 Exhibit No. \_\_\_\_ (TMH-8) for additional explanation of the program.

12 **Q. Why is the level of available incentive payments based on Service Quality**  
13 **Indices and Earnings Per Share?**

14 A. These two measures provide a clear summary for employees of what success  
15 means—that employees accomplish both the Company's annual objectives and  
16 continue providing good customer service. If customer service quality measures are  
17 not met, then the accomplishment of annual objectives is incomplete. Earnings per  
18 share is related in part to the Company's ability to control costs and stay within its  
19 budget. The annual budget process recognizes that it costs money to develop and  
20 maintain the utility's infrastructure and meet current and future customer needs.

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PSE completes a calendar year budgeting process whereby the Company forecasts expected expenses and revenues. The forecast for expenses includes expenditures on all needed activities for the year that will provide continued safe, reliable service for customers as well as executing on required compliance and plans for future customer needs. The net result of forecast expenses and revenues from this comprehensive budgeting process is expected earnings which is easily tracked and easily understood by employees. If employees and managers are not controlling expenses per the budget, then expected earnings will not be achieved.

1 **Q. Is PSE continuing with the Goals and Incentive Plan after the merger of Puget**  
2 **Energy and the investor consortium?**

3 A. Yes, the Goals and Incentive plan will continue to offer employees the same  
4 incentive opportunity as previous years. The program is an important part of the  
5 Company's pay-for-performance compensation philosophy and is supported by the  
6 Company's new owners. The EPS measure used in the 2008 Goals and Incentive  
7 plan will be replaced with a performance measure that makes sure the Company is  
8 meeting its financial budget. The continuance of SQIs as a metric for the Goals and  
9 Incentive Plan recognizes the importance of customer service, reliability and safety  
10 are maintained.

11 **Q. Is the Company seeking recognition and recovery of annual incentive plan**  
12 **compensation in this proceeding?**

13 A. Yes, except for the incentive payments made to Company officers. Although the  
14 Commission has ruled in recent cases that all of PSE's incentive plan costs can be  
15 recovered in rates because they are tied to service quality, safety, and reliability  
16 considerations, PSE has decided – in this case only – not to seek recovery of  
17 incentive payments made to officers. As with the freeze on Company officers'  
18 salaries at 2008 levels, the Company is removing the cost of the officers' incentives  
19 in consideration of the difficult economic times customers are facing. The

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Company will seek recovery of officer incentive compensation in future rate cases,  
however, as the recovery of such compensation is appropriate and reasonable.

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**V. CONCLUSION**

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**Q. Does that conclude your testimony?**

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A. Yes, it does.