Exhibit No. __ T (BAE-1T)
Dockets UE-111048/UG-111049
Witness: Betty A. Erdahl

BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**DOCKET UE-111048** **DOCKET UG-111049** ***(Consolidated)***

TESTIMONY OF

BETTY A. ERDAHL

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Revenue Requirement Adjustments:
Operating Expenses - Board Fees and Expenses, CEO Allocation Factor, Incentive Pay, D&O Insurance, Pension Plan, Wage Increases, Investment Plan, and Employee Insurance

December 7, 2011

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LIST OF EXHIBITS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Betty A. Erdahl and my business address is the Richard Hemstad Building, 1300 S. Evergreen Park Drive SW, P.O. Box 47250, Olympia, Washington 98504. My business e-mail address is berdahl@utc.wa.gov.

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission ("Commission") as a Regulatory Analyst in the Regulatory Services Division.

Q. Please describe your education and relevant work experience.

A. I graduated from Washington State University in 1988 with a Bachelor of Arts degree in Accounting. I have also completed coursework in "Basics of Regulation" offered by New Mexico State University, Rate Making Process Technical Program, USTA class on Understanding Separations, Access Charges, and Settlements, as well as Utility Ratemaking: The Fundamentals and the Frontier. Before joining the Commission in June 1991, I worked for two years as an accountant in the financial sector.

As a Regulatory Analyst, I am responsible for auditing the books and records of regulated companies, analyzing cost of service studies, and examining affiliated interest transactions. In addition, I participate in the development of Staff recommendations concerning tariff filings by regulated companies for presentation to the Commission at open public meetings and adjudications. I have also worked on policy recommendations relating to spin-offs and mergers of regulated companies, payphone deregulation, local calling areas, bundling of regulated and nonregulated telecommunications services, implementation of N11 pursuant to the Telecommunications Act of 1996, and numbering resources.

Q. Have you testified before this Commission?

A. Yes. I testified in Docket TG-920090, regarding affiliated interests of Waste Management, Inc.; Docket UT-950200, regarding a general rate case of U S WEST Communications, Inc.; Docket UT-970066, regarding payphone access line rates of Toledo Telephone Company; and Docket UT-020406, a complaint by AT&T Communications of the Pacific Northwest, Inc. against Verizon Northwest Inc.'s access charge rates. I also prepared testimony in Docket UT-040788, regarding a general rate case of Verizon Northwest Inc.; Docket UT-051291, regarding affiliated interest contracts, overall earnings review, and provision of a quality of service guarantee program in the Sprint spin-off of its local exchange companies; and Docket UT-082119, regarding retention of pre-merger settlement provisions, a requirement to offer a quality of service guarantee program, and affiliated interest reporting in the CenturyTel/Embarq merger case.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the purpose of your testimony in this proceeding?

A. My testimony presents Staff's recommendation regarding the following seven adjustments proposed by Puget Sound Energy, Inc. ("PSE" or "the Company") for its electricity and natural gas results of operations:

- Adjustments 14.06 and 6.06G, Operating Expense – Board Fees and Expenses, CEO Allocation Factor
- Adjustments 14.10 and 6.10G, Incentive Pay
- Adjustments 14.13 and 6.13G, D&O Insurance
- Adjustments 14.18 and 6.18G, Pension Plan
- Adjustments 14.19 and 6.19G, Wage Increase
- Adjustments 14.20 and 6.20G, Investment Plan
- Adjustments 14.21 and 6.21G, Employee Insurance

The results of my analysis are incorporated into the summary revenue requirement exhibits of Staff witnesses Martin for PSE's electric operations (Exhibit No. __ (RCM-2) and Mickelson for PSE's natural gas operations (Exhibit No. __ (CTM-2)

Q. Which Company adjustments that you have reviewed are uncontested by Staff?

A. The following adjustments are uncontested by Staff:

- Adjustments 14.18 and 6.18G, Pension Plan

Q. Does Staff contest all of the remaining Company adjustments within your area of responsibility?

A. Yes.

Q. Are you sponsoring any exhibits in support of your testimony?

A. Yes. I sponsor the following exhibits in support of my testimony:

- Exhibit No. ___ (BAE-2), Staff Operating Expense Adjustments: Board Fees and Expenses, CEO Allocation Factor
- Exhibit No. ___ (BAE-3), Staff Incentive Pay Adjustments
- Exhibit No. ___ (BAE-4), Staff D&O Insurance Adjustments
- Exhibit No. ___ (BAE-5), Staff Wage Increase Adjustments
- Exhibit No. ___ (BAE-6), Staff Investment Plan Adjustments
- Exhibit No. ___ (BAE-7), Staff Employee Insurance Adjustments

III. DISCUSSION

A. Adjustments 14.06 and 6.06G, Operating Expense Adjustments –Board Fees and Expenses, and CEO Allocation Factor

Q. Please describe the Company's adjustments to Board Fees and Expenses, and CEO Allocation Factor.

A. PSE removed a portion of the Board Meeting Expenses. This allocation is based on the portion of the agenda for each meeting that is related to non-utility topics.

Additionally, PSE removed Steven P. Reynolds' salary (Mr. Reynolds retired March 1, 2011) and adjusted the test year salary of Kimberly Harris to reflect her pay as the new Chief Executive Officer ("CEO"). The Company allocated 93.09 percent of Ms. Harris' wages to utility operations expense even though only 90.20 percent of Mr. Reynolds' salary had been charged to utility operations in the test year.

Q. How do Staff's adjustments differ from the Company's adjustments?

A. Staff removed 50 percent of the Board Fees and Expenses that were booked above the line and included in proposed rates by PSE. The rationale for Staff's approach is that the Board of Directors provides services equally benefiting shareholders as ratepayers. Staff's adjustments are also consistent with the Commission's decision in Avista Dockets UE-090134, UG-090135 and UG-060518.[1]

With regard to the CEO Allocation Factor, Staff applied the same percentage allocation of wages to O&M Expenses for Ms. Harris as was realized in the test year for Mr. Reynolds (90.20 percent). Staff's approach is justified because:

1. No data was provided by the Company supporting a change to the duties of Ms. Harris and the related allocation factor for the CEO wages.
2. It is reasonable that the new CEO will spend similar time on similar duties to that of the retired CEO.

Staff's adjustments increase electric and natural gas net operating income by $349,996 and $176,235, respectively. Staff's adjustments are shown in Exhibit No. __ (BAE-2).

B. Adjustments 14.10 and 6.10G, Incentive Pay Adjustments

Q. Please describe the Company's adjustments to Incentive Pay.

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[1] *WUTC v. Avista Corporation*, Dockets UE-090134, UG-090135 and UG-060518, Order 10, ¶141-142 (December 22, 2009).

A. PSE's adjustments use a four year average of incentive compensation paid to employees and exclude officer incentive pay. This methodology has been accepted by the Commission in prior cases for PSE.

Q. Please explain Staff's adjustments to Incentive Pay.

A. Staff accepts the four year average of incentive compensation paid to employees and the adjustment to exclude officer incentive pay.

However, Staff also proposes to remove 50 percent of incentive pay from the test year. The incentive pay is based on meeting certain standards, or achieving stated goals, relating to nine service quality indices ("SQIs"), while also achieving certain financial metrics. Staff recommends that incentive pay be allowed in rates only when it is tied to service quality, because that is what benefits the ratepayers. Therefore, Staff's adjustments remove incentive pay related to the financial metrics.

Q. Please explain how the Company's Incentive Pay system operates.

A. As reflected in the payout matrix provided in PSE's response to Staff Date Request No. 150, Attachment A, the Company pays out incentives based on how employees perform with regard to service provided and financial goals met.

The Company met all nine of the SQIs in the test year; however, it did not meet 100 percent of the financial metrics. Based on the way the incentive plan is designed, it is possible for all SQIs to be achieved and no financial metrics realized, resulting in a payout of zero with regard to the service quality indices. Staff believes this is where the incentive plan fails: it does not pay an incentive when SQIs are met regardless of financial metrics achieved, resulting in a potential decreased focus on SQIs. Additionally, the reverse could occur with less focus on SQIs in order to meet financial metrics to assure incentive pay is achieved.

Q. Please explain the rationale for Staff's adjustments to Incentive Pay.

A. There are many reasons why it is appropriate to remove the cost of incentive pay that relates to financial metrics, as proposed by Staff. First, ratepayers already pay for O&M Expenses; they should not pay an additional expense for incentive pay related to financial metrics because they do not receive any benefit when PSE achieves the financial goals. Rather, incentive compensation pay based on financial metrics benefits shareholders. Shareholders, therefore, should bear the full cost of incentive pay related to financial metrics. The Company has the burden to show otherwise and has failed to carry that burden.

Second, if incentive pay is incorporated into rates, as PSE proposes, and the Company does not pay those incentives in the rate year, then ratepayers are further disadvantaged because they are held responsible for a cost not incurred by the Company.

Finally, Staff recognizes that the Commission has allowed incentive pay related to earnings to be recovered in rates, as in the last Avista rate case.[2] However, the Commission also directed Avista to address whether ratepayers should pay such expense when they already bear the burden of the full costs of O&M. Staff believes

[2] *WUTC v. Avista Corporation*, Dockets UE-090134, UG-090135 and UG-060518, Order 10, ¶ 128-129 (December 22, 2009).

this standard should apply equally to all regulated utilities. Staff's adjustments are also consistent with the Commission's decisions in prior Avista Dockets UE-991606, UG-991607, Puget Sound Power & Light Docket UE-920433, and U S WEST Docket UT-950200.[3]

Q. Are the SQIs and financial metrics linked and dependent on each other?

A. Yes, this was the Company's assertion in its response to Staff Data Request 50. In fact, there is an elastic scale for calculating incentive payout where the percentage related to SQIs vs. financial metrics changes depending on the achievement of service quality and financial metrics. Based on the data provided by PSE, Staff's adjustment to remove only 50 percent of the test year incentive pay is fair to the Company.

Staff's adjustments increase electric and natural gas net operating income by $2,277,270 and $1,117,331, respectively. Staff's adjustments are shown in Exhibit No. __ (BAE-3).

C. Adjustments 14.13 and 6.13G, D&O Insurance Adjustments

Q. Please describe the Company's adjustments to D&O Insurance.

A. The Company's adjustment restates the portion of the Directors and Officers ("D&O") Insurance that should be allocated to Company subsidiaries.

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[3] *WUTC v. Avista Corporation*, Dockets UE-991606 and UG-991607, Third Supp. Order, ¶ 271 (September 29, 2000); *WUTC v. Puget Sound Power & Light Co.*, Docket UE-020433, 11th Suppl. Order, page 61 (September 21, 1993); *WUTC v. U S West*, Docket UT-950200, 15th Supp. Order, page 47 (April 11, 1996).

Q. How do Staff's adjustments differ from PSE's adjustment?

A. Staff recognizes the restating adjustment made by PSE, but makes an additional adjustment to remove 25 percent of D&O Insurance, which represents half of the expense that is related to Directors. Staff's approach is different from the approach it advocated in the last PSE rate case which was rejected by the Commission: disallow 50 percent of <u>all</u> D&O Insurance.[4]

Q. Please explain the rationale for Staff's adjustments.

A. Approximately 50 percent of the total D&O Insurance expense is related to the Directors. In this case, Staff removed half of that amount to be booked below the line. The Board of Directors provides services that benefit shareholders to the same extent they benefit ratepayers. Therefore, it is fair that shareholders equally share this cost that serves their financial interest in PSE.

Staff's adjustments are also consistent with Staff adjustments 14.06 and 6.06G related to Director Fees and Expenses, and with the Commission's decision regarding Director's Fees and Meeting costs in Avista Dockets UE-090134, UG-090135 and UG-060518.[5]

Staff's adjustments increase electric and natural gas net operating income by $77,591 and $54,009, respectively. Staff's adjustments are shown in Exhibit No. __ (BAE-4).

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[4] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-090704 and UG-090705, Order 11, ¶ 60 (April 2, 2010).
[5] *WUTC v. Avista Corporation*, Dockets UE-090134, UG-090135 and UG-060518, Order 10, ¶ 141-142 (December 22, 2009).

D. Adjustments 14.19 and 6.19G, Wage Increase Adjustments

Q. Please describe the Company's adjustments to increase wages.

A. The Company proposes to increase wages for the International Brotherhood of Electrical Workers ("IBEW") union employees, the United Association of Plumbers and Pipefitters ("UA") union employees, and non-union employees.

The proposed wage increases for the IBEW employees run from September 1, 2010 through March 31, 2014. PSE proposes a compounded wage increase for IBEW employees of 4.51 percent. This provides for all wage increases up to and including the entire rate year.

The wage increases for UA employees run from October 1, 2010 through September 30, 2013. The Company proposed a compounded wage increase for UA employees of 5.33 percent. This adjustment also calculates all wage increases up to and including the entire rate year.

The average wage increase for non-union employees includes the actual increase paid in March 2011 of 3.24 percent, which is weighted by prior year effective salary increases. This is done in order to account for "slippage" when new non-union employees are hired at a lower salary than more senior employees who have left the Company. PSE proposes an effective wage increase of 2.97 percent for non-union employees as a result of slippage.

Additionally, payroll taxes are adjusted in relation to the proposed wage increases.

Q. How do Staff's adjustments to wages differ from the Company's adjustments?

A. Staff proposes to increase wages by all union contracted amounts, but only through May 15, 2012 resulting in a compounded wage increase of 2.19 percent for IBEW employees and 2.26 percent for UA employees. Staff accepts the Company's adjustment for non-union employees since the wage increase for these employees was actually paid in March 2011.

Q. Why should the Commission accept Staff's adjustments over the Company's for union employees?

A. Staff's adjustments should be adopted by the Commission for several reasons. First, PSE's adjustment includes increases that take effect beyond the beginning of the rate year, which is too remote from the end of the test year to be included without risk of violating the matching principle. In doing so, the Company's adjustment is not a proper pro forma adjustment because it does not account for potentially offsetting factors such as productivity increases or other expense savings. In fact, in the last PSE rate case, the Commission determined that to allow wage increases beyond four months after a test year is too remote and would risk violating the matching principle.[6]

This is especially true given the history of regular general rate case filings by the Company. PSE is likely to be afforded an additional rate increase prior to March 31, 2014, which is the date it proposes in this case for the union wage increases to

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6 *WUTC v. Puget Sound Energy, Inc.*, Docket UE-090704 and UG-090705, Order 11, ¶ 88 (April 2, 2010).

cover. Again, it would be unfair for rate payers to bear the burden of wage increases that far into the future without consideration of offsetting expenses.

The effect of Staff's adjustments reduces electric and natural gas net operating income by $1,512,830 and $769,423, respectively. Staff's adjustments are shown in Exhibit No. __ (BAE-5).

E. Adjustments 14.20 and 6.20G, Investment Plan Adjustments

Q. Please describe the Company's adjustments to the investment plan.

A. PSE's adjustments to the investment plan increase the Company portion of the plan expense to reflect the additional expense related to wage increases and is based on the current average employee contribution rates.

Q. How do Staff's adjustments differ from the Company's adjustments?

A. Staff's adjustments are similar to the Company's, except Staff applied the compounded IBEW employee wage increase of 2.19 percent and the compounded UA employee wage increase of 2.26 percent, as discussed earlier in the wage adjustment section of my testimony.

Staff's adjustments reduce electric and natural gas net operating income by $83,624 and $40,613, respectively. Staff's adjustments are shown in Exhibit No. __ (BAE-6).

F. Adjustments 14.21 and 6.21G, Employee Insurance Adjustments

Q. Please describe the Company's adjustments for Employee Insurance.

A. PSE adjusts employee insurance expense to the expected average cost per participant for the rate year. This adjustment is calculated using the average rate per participant and applying that rate to the average participation during the test year. The average participation used in PSE's adjustment does not take into account employees that were laid off in 2010.

Q. How do Staff's adjustments differ from the Company's adjustments?

A. Staff's adjustments use the end of year participation count, not the average participation count for the year which includes employees that were laid off. Staff's adjustments result in applying the average cost per participant to 2,803 participants in December compared to the 2,841 <u>average</u> participant count used by the Company.

Q. Please explain the rationale for the Staff methodology.

A. Staff's calculation uses the average Company cost of $953 per month per participant from the UA contract, rather than the Company average rate of $988 per month per participant that PSE used in its adjustments. The cost in the UA contract is known and measurable, any amount above that is not.

Moreover, while PSE calculated an average rate per participant, there was no detailed analysis indicating why the higher average rate was paid. Approximately 38 employees were laid off in 2010. Additionally, 16 employees were laid off in 2011, although the headcount of non-temporary employees remained virtually flat over 2011. In any case, the higher calculated average insurance rate is not known and measurable. The Company bears the burden to support a number other than what is included in the union contract.

Finally, in response to Staff Data Request No. 198, PSE states that it does not have an obligation to contribute to an employee's insurance costs once that person is laid off. According to PSE's work papers 6.21E & G, the average employee participation count is relatively consistent from August through December 2010. These participation counts reflect the layoffs that occurred earlier that year. Therefore, to use an annual average count of participants, as was done by PSE, overstates the insurance costs in this case because there is a known and measurable decrease to participant counts.

Staff's adjustments increase electric and natural gas net operating income by $69,939 and $33,966, respectively. Staff's adjustments are shown in Exhibit No. __ (BAE-7).

Q. Does this conclude your testimony?

A. Yes.