EXHIBIT NO. TMH-9CT
DOCKET NO. UE-090704/UG-090705
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-090704 Docket No. UG-090705

PREFILED REBUTTAL TESTIMONY (CONFIDENTIAL) OF THOMAS M. HUNT ON BEHALF OF PUGET SOUND ENERGY, INC.

REDACTED
VERSION

DECEMBER 17, 2009

PUGET SOUND ENERGY, INC.

PREFILED REBUTTAL TESTIMONY (CONFIDENTIAL) OF THOMAS M. HUNT

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PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

Q. Are you the same Thomas M. Hunt who provided prefiled direct testimony and exhibits in this proceeding on May 8, 2009, on behalf of Puget Sound Energy, Inc. ("PSE" or "the Company")?

A. Yes.

Q. Please summarize the purpose of your rebuttal testimony.

A. This rebuttal testimony responds to the recommendations of Public Counsel witness James R. Dittmer regarding wage increases, employee benefit flexible credits, and retirement programs; Federal Executive Agency witness Ralph C. Smith regarding retirement programs; and Commission Staff witness Joanna Huang regarding wage adjustments.

In Section II of my testimony, I will address the PSE retirement programs questioned by Mr. Dittmer and Mr. Smith, including PSE's market competitive plans for all employees and the market competitive specialized retirement plan for executives. These retirement programs are widespread in the utility industry and provide benefits for customers by attracting and retaining a qualified, career-minded workforce.

In Section III of my testimony, I address wage adjustments proposed by Mr. Dittmer and Ms. Huang and employee flexible benefit credit adjustments proposed by Mr. Dittmer. The Company's proposed adjustments are moderate, consistent with prior rate proceedings, and allow for market competitiveness for wages and benefits.

II. REBUTTAL OF RETIREMENT PROGRAM ADJUSTMENTS

Q. Public Counsel Witness Dittmer and FEA Witness Smith both propose adjustments to the Company's rate recovery of retirement programs. Do you agree with those adjustments?

A. No. Retirement programs are an essential part of PSE's total compensation, recruiting and retention program for all employees, including executives. My testimony in this section will show that PSE's programs are market competitive, benefit the customer, and therefore are reasonable to include in rates. PSE's represented workforce has received these benefits as a result of collective bargaining agreements in place since 1959. The witnesses propose changes from PSE's current rate treatment that in essence seek for customers to continue receiving the benefit of a skilled, stable workforce without paying for the compensation programs needed to attract and retain these employees. I will also show that, contrary to trends Mr. Smith describes, both defined benefit pension and defined contribution savings plans are the norm within the utility marketplace and are part of a competitive compensation package. Finally, I will show that

SERP retirement programs for executives are not excess pay programs such as Mr. Dittmer suggests, but are the norm within the utility marketplace and part of a competitive executive compensation package used to attract and retain executives, especially executives joining PSE in mid-career.

A. <u>Qualified Retirement Plan is Market Competitive</u>

Q. What is the Company's defined benefit pension plan and whom does it benefit?

A. As described in my prefiled direct testimony at page 17, lines 10-12, the Retirement Plan for Puget Sound Energy ("Retirement Plan") is a defined benefit pension plan and part of the overall retirement program PSE offers employees to encourage them to work their career at PSE. Along with the Retirement Plan, PSE offers the Investment Plan for Puget Sound Energy ("Investment Plan") which is a defined contribution 401(k) plan.

In the Retirement Plan, PSE commits to provide a benefit to vested plan participants at retirement. Vesting in the plan occurs after three calendar years with at least 1,000 hours per year for the cash balance formula and after five calendar years with at least 1,000 hours per year in the final average earnings or "FAE" formula. Therefore, PSE's career-minded employees and their families benefit from the defined benefit program.

PSE's management and customers also benefit from having the defined benefit plan because, as mentioned above, the plan attracts and retains stable employees who want to develop a career at PSE. Employees working a short time at PSE do not receive any benefits from the plan. Retirement security is a significant issue for employees and in fact the whole country, as shown by the passage of the Pension Protection Act of 2006 and prior legislation such as the Employee Retirement Income Security Act of 1974.

Q. Is it true, as Mr. Smith testifies, that defined benefit pensions are going away?

A. In some industries, defined benefit plans are not widely offered. Relatively new companies such as Microsoft, T-Mobile, or Costco never offered defined benefit pensions but often provide employees other benefits such as employee discounts on service or merchandise, broadly available employee stock programs used to build wealth, etc. However, in the utility industry, defined benefit plans are still widely used. PSE's response to FEA Data Request No. 4.09, confidential Attachment A provided a market survey completed October 2009 by EAP Data Information Solutions, LLC, which showed that all but one surveyed utilities have both a defined benefit plan and a defined contribution savings program. *See* the attached report attached hereto as Exhibit No. TMH-10C. The utility industry has seen some changes within defined pension design – such as the use of cash balance formulas like PSE's formula for the non-represented and UA-represented employees that was instituted in 1998 – but has maintained both defined benefit and defined contribution plans.

Two factors help explain why the utility industry's programs have remained more "traditional." First, the employment market for many utility company jobs is a mixture of investor-owned utilities and public utilities. PSE's labor market for skilled craft workers and entry-level professionals includes public utilities such as Snohomish Public Utility District and Seattle City Light because these positions are generally filled from within the region. These public utilities usually offer defined benefit retirement programs, which creates a market competitive need to maintain PSE's program. Secondly, union negotiations are required to change union pension plans, and unions have typically urged their members to keep defined benefit pension programs. PSE and the IBEW union proposed converting the IBEW's Final Average Earnings formula to a cash balance formula as part of 2007 contract negotiations, but a majority of voting IBEW members rejected the proposal.

Q. What modifications to the Company's pension revenue requirement did witnesses propose?

A. Witnesses took a variety of positions, from recommending no change to recommending a completely different basis for calculating pension-related rate expense. Washington Commission staff witnesses did not propose any changes. Public Counsel witness Dittmer recommended a different time period for calculating the average of PSE's actual pension contributions. PSE witness Michael J. Stranik provides rebuttal testimony related to Mr. Dittmer's proposed adjustment. FEA witness Smith recommended replacing the Commission's current methodology for calculating the pension revenue requirement with one based on a historic average of accounting expense. (Public Counsel witness Dittmer also testified that he was surprised that the Commission's rate recovery methodology was based on cash contributions, but he did not recommend that the Commission change the treatment.) Mr. Stranik provides rebuttal testimony related to PSE's historic rate treatment and why Mr. Smith's proposal is unfounded. My testimony considers the proposals of Mr. Dittmer and Mr. Smith from the perspective of their impact to PSE's competitive total compensation position. Both proposals should be rejected by the Commission because they look at PSE in isolation or in comparison to recent years when PSE's pension was fully funded.

Q. In his confidential Table V on page 57 of his testimony, Mr. Dittmer states that PSE forecasts the 2009 market return will be a [redacted] and he concludes that the Company's "significantly pessimistic" projection means that "prudent contribution levels and actuarially determined pension costs also shown on the table can likewise expect to be modified significantly downward." Do you agree with this analysis?

A. No. Unfortunately, Mr. Dittmer misinterpreted the report from PSE's pension actuarial firm, Milliman, which was provided to Public Counsel in PSE's response to Public Counsel Data Request No. 15. The row in the report Mr. Dittmer used for market returns was labeled "Actual Return (on prior year's Market Value)" and for 2008 and 2009 the values shown are the prior year's actual market return. The [redacted] that Mr. Dittmer interpreted as a pessimistic assumption on PSE's part for 2009 is the actual 2008 return. The [redacted] value shown for 2008 was the 2007 actual return. The estimate for 2009 market returns from the report was [redacted]. The notes on page 2 of the report state: "Projects 5/31/2009 MVA at 8.25% return." The actual year-to-date return through May 31, 2009 for the Retirement Plan was *positive*, and Milliman's projection for the remainder of 2009 at the annualized actuarial assumption of 8.25% provided the [redacted] rate shown.

Q. Should Mr. Dittmer have known that these market returns were associated with the prior years?

A. Yes. First of all, the 2008 actuarial report for PSE's Retirement Plan was provided on July 9, 2009 as confidential Attachment C to PSE's Response to Public Counsel Data Request No. 12. The 2008 actuarial report is attached here as Exhibit No. TMH-11C. On several places in the report, market returns for 2007 and 2008 are shown, including page 2 "The Plan's assets experienced a significant decline during 2008. The approximate return for the year was [redacted]" and in Exhibit 4 [redacted]". These are the identical return figures applied by Mr. Dittmer to the wrong years. Beyond this definitive information listed in the actuarial report, the fact of large pension plan losses in 2008 was a feature topic of my initial testimony, and was incompatible with interpreting the report as showing a [redacted] positive market return in 2008.

Q. Based on this misinterpretation of forecast market return for 2009, are Mr. Dittmer's conclusions correct?

A. No. Mr. Dittmer's testimony on pages 57 and 58 after Table V derive from his misinterpretation and are incorrect. His conclusion that PSE's 2009 return assumptions were pessimistic and his expectation that PSE's project pension contributions and pension accounting costs should be expected to decrease significantly downward are therefore both incorrect.

In PSE's Response to FEA Data Request No. 04.03 on November 18, 2009, PSE provided confidential Attachment A, a ten-year projection of forecast Retirement Plan actuarial expense and contributions. The report is similar in format to the earlier report analyzed by Mr. Dittmer and starts from an updated market value of assets as of August 24, 2009. The report is attached as Exhibit TMH-12C. The plan return figures, pension expense and contribution figures for 2008 and 2009 are unchanged, while the report shows in future years PSE's pension contributions are expected to be level at around [redacted] not to decrease significantly, and PSE's actuarial pension expense rises to a peak in 2013 of [redacted] and stays higher than forecast pension contributions until 2017.

Q. Mr. Dittmer's adjustment on Schedule C-7 of his Exhibit Nos. JRD-2C and JRD-3C is derived from calculating the four-year average contributions for the four calendar years ending in December 2008. Does PSE agree with this adjustment?

A. The Company does not agree with the proposed adjustment and Mr. Stranik's testimony provides rebuttal. I will emphasize that the 2009 funding amounts removed by Mr. Dittmer were based on PSE's pension funding policy. Attached as Exhibit TMH-13C is the pension funding policy, which was previously provided in PSE's Response to Public Counsel Data Request No. 010, as Attachment C, pages 1-13. The goal of the policy is expressed on page 3 "Establish a reasonable and consistent pattern of employer contributions" and "Contribution decision guided by: [redacted] to provide for benefit security in volatile markets, [redacted] (PPA basis) as 12/31, to avoid PPA benefit restrictions and PBGC special reporting in following year."

PSE implemented this pension funding policy in light of dramatic stock market turmoil and plan asset losses during 2008, and used this funding policy for the contribution of $24.5 million made in December 2008. Attached as Exhibit No. TMH-14C is a report showing PSE's Retirement Plan asset market values, projected benefit obligation ("PBO"), and contributions monthly from December 31, 2007 through November 30, 2009. The exhibit calculates the Retirement Plan's "PBO Funding %" which is a value mentioned as a long-term target in the funding guideline. The chart in the exhibit clearly shows the dramatic drop in plan assets starting after August 2008. In November 2008, the asset value had [redacted] since December 31, 2007 and was [redacted] while the PBO Funding % had [redacted], a level where Pension Protection Act restrictions could apply. When this rate case was filed in May 2009, the Retirement Plan's asset values [redacted] the 2008 contribution and a $6 million contribution in April 2009. Pursuant to the funding policy, 2009's 18.4 million in contributions were intended to help restore the plan's funding level and have in fact been contributed to the pension plan's trust.

Q. Exhibit No. TMH-14C provides PSE Retirement Plan information as of month end November 2009. What is the funded status of the plan as of November 30, 2009 and does the funded status of the plan impact whether PSE will make contributions during 2010?

A. As seen on the chart and table in Exhibit No. TMH-14C, the market value of assets has rebounded considerably from year-end 2008 and the low point of February 2009. As of November 2009, the market value of assets were [redacted] compared to 3rd Quarter 2009 PBO of [redacted], or [redacted] of PBO, meaning that the plans assets slightly exceed obligations. The PBO will be re-measured by PSE's actuaries again at year-end 2009, and PBO is expected to be higher, as was the case when it was re-measured at prior quarters. Additionally, the Company's actuaries have indicated that discount rate assumptions based on the Citigroup yield curve for the plan will be lower at year-end 2009, which increases PBO. If the current market value of assets is maintained, the plan will be better funded at year-end 2009 than at the start of the year, a positive change driven primarily by investment gains, and secondarily by company contributions.

With the recovery in market value of assets, PSE's 2010 contributions will be lower than they otherwise would have been. The change can be seen by looking at the June 2009 forecast contribution for 2010 of [redacted] (from PSE Response to Public Counsel Data Request No. 015, Attachment A) and the September 2009 forecast for 2010 of [redacted] (Exhibit No. TMH-12C). PSE's actuarial firm Milliman will recalculate the pension funding guideline for 2010 after revaluing the PBO and based on final 2009 market asset values. Pension Protection Act ("PPA") minimum funding guidelines will still apply to PSE's pension, and because PSE's pension funding guideline, Exhibit No. TMH-13C, seeks to achieve a long-term funding status of 120% of PBO, the 2010 funding guideline will likely show a range of contributions around the [redacted] level, which was the consistent contribution level for 2010 through 2017 shown in Exhibit No. TMH-12C. During 2006 and 2007 when PSE had no required PPA contributions, the market value of assets exceed 120%. In fact, even with the improved market value at November 2009, the plan is [redacted] the December 31, 2007 asset level, and the PBO has grown since 2007.

Q. Has PSE's funding of the pension displayed any aspect of Mr. Smith's concern on page 18 of his testimony about contributions being "subject to significant manipulation for purposes of deriving an expense allowance in a rate case"?

A. No. PSE's contributions to the Retirement Plan 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. Mr. Smith's own testimony highlights that in 2006 and 2007 PSE could have contributed up to [redacted], respectively, to the pension, but actually contributed $0 because the plan was fully funded at that time. Additionally, PSE's 2008 contribution could have been as high as [redacted] per pension regulations, but PSE contributed $24.5, following the Company's pension funding guidelines and recognizing the size of the funding gap at that time was [redacted], as shown on Exhibit No. TMH-14C. For 2009, PSE's maximum deductible contribution is [redacted] as shown in the 2008 actuarial report (Exhibit No. TMH-11), page 4), but the 2009 guideline contribution range calculated in March 2009 was $18.4 to [redacted] as provided in PSE's Response to Public Counsel Data Request No. 011, Attachment D and attached here as Exhibit No. TMH-15C. PSE has contributed the low end of this guideline, $18.4 million to the Retirement Plan for 2009.

Q. Did Mr. Smith comment on the funding guidelines that PSE implemented?

A. Yes. Mr. Smith's testimony beginning at page 15, line 22 describes the range of contributions from the pension funding guidelines. He did not, however, address PSE's 2008 actual contribution and funding guideline in context. In 2008, PSE contributed an amount at the top of its internal guideline, but at a level that still left the plan underfunded, and the amount contributed was less than half of the possible Pension Protection Act funding maximum. As mentioned above, the 2009 contribution was at the bottom of the guideline level.

Q. Is pension expense rising at other utilities?

A. Yes. Key factors of the Pension Protection Act and market losses are affecting all companies. Within Washington, Avista Corporation's pension experience was documented in their recent general rate case. During the last five years (2004-2008), Avista contributed $88 million to their pension, and over the same period had $62.6 million of FAS 87 expense (Docket UE-090134 Direct Testimony of Mark T. Thies, page 36). During this same period, PSE contributed $24.5 million in 2008. Avista's forecast contribution for 2009 was "at least $42 million, and more recent analysis indicates that we may need to contribute $67 million." PSE's actual contribution for 2009 was $18.4 million.

Q. How do PSE's retirement programs encourage employee retention?

A. The programs have two components that encourage retention. First is the vesting schedule of three years or five years, depending on the formula in the defined benefit pension. Second, both formulas in the Retirement Plan provide more value as an employee increases in tenure. In the FAE formula, years of credited service and higher pay increase the annuity to be paid. In the cash balance plan, the annual pay credit percent increases with age, so that a participant who is age 60 or above is receiving an annual company credit of 8% to his/her pension cash balance. In contrast, an employee younger than 30-years-old has a credit of 3%.

Q. **How large is the plan contribution used in revenue requirements compared to the Retirement Plan's annual payment to retirees?**

A. The Retirement Plan made distributions to retirees and beneficiaries of [redacted] during 2008 as shown on the attached Exhibit No. TMH-16C, a report summarizing PSE's Retirement Plan from 1999 to 2008, including payments to beneficiaries and annual investment returns. During the last five years of 2004-2008, payments to beneficiaries have been [redacted], compared to company pension contributions of $24.5. Looking forward, forecast payments to retirees and beneficiaries for the next five years (2010 through 2014) are [redacted],[1] while forecast company contributions are [redacted].[2]

Q. **Does the use of FAS 87 accounting expense prevent utilities from having higher regulatory expense in market conditions such as we have witnessed?**

A. No. Currently the use of FAS 87 accounting expense would make revenue amounts less volatile, but when market returns are poor and a pension plan becomes underfunded, the FAS 87 expense can also dramatically increase. Interest rate assumptions can also create volatility in the accounting expense

[1] Exhibit No. TMH-11C, 2008 actuarial report exhibit 41.
[2] Exhibit No. TMH-12C.

figures. For example, PacifiCorp's pension (for all its employees, not employees serving Washington customers) per the PacifiCorp 2008 SEC Form 10-K page 101, finished 2008 with assets of $692 million, obligations of $1,070 million, for underfunding of $378 million. PacifiCorp's 10-K also describes the regulatory asset related to the pension as, "Regulatory assets represent costs that are expected to be recovered in future rates" and for "employee benefit plans" showed $564 million for 2008. Additionally, as can be seen on Exhibit No. TMH-12C, PSE's projected pension actuarial expense from 2013 through 2017 is higher than projected cash contributions.

Q. Mr. Smith compared his recommended change in regulatory recovery of pension costs to the Washington Commission's 1992 decision about Puget Power & Light's post-retirement medical program. Is this an appropriate precedent?

A. No. The circumstances of the 1992 decision were quite different from Mr. Smith's recommendation in this case. At that time, new accounting rules required companies to establish the estimated cost of their commitments to post-retirement medical programs, similar to the accounting already in place for retirement programs. In complying with the 1990's change in accounting standards, Puget Power & Light's obligations under its post-retirement medical program became clearer and the Washington Utilities and Transportation Commission ruled that the programs were not prudent. In contrast, the obligations of the retirement plan have always been clear and financial reporting guidelines continue to increase the detail of required reporting. Mr. Smith's suggestion to change revenue treatment seems to have less to do with whether the Retirement Plan obligations were known, but instead a desire to reduce pension expense by choosing a different measure.

Q. Mr. Smith questioned whether PSE should continue to offer a defined benefit pension. What did he suggest?

A. Mr. Smith's testimony at page 18, lines 15-22, was: "It may therefore be a good time for a re-evaluation of the cost of this benefit program and consideration of alternatives such as a defined contribution plan, where the employer's cost for the year is know and is not subject to radical increases based on investment performance, which can be variable."

Q. How would this suggestion work for PSE?

A. PSE already offers both a defined benefit and a defined contribution plan, as do 97% of the utilities surveyed. *See* Exhibit No. TMH-10C. Because PSE has both plans, Mr. Smith's suggestion would either eliminate a portion of PSE's retirement program, thereby diminishing the Company's competitive market position, or his suggestion would move expense from the defined benefit plan to the defined contribution plan. The Investment Plan would not have the same employee retention qualities, because participants are immediately vested in their company matching contributions in the Investment Plan, compared to the three-year and five-year vesting in the Retirement Plan. And, as noted above a change to either program would also require negotiations between PSE and its unions and approval by a majority of members in a contract vote.

Q. Are Investment Plan, expenses included in revenue requirements?

A. Yes, the current Investment Plan expense is included in revenue requirements.

B. <u>PSE'S Supplemental Executive Retirement Plan (SERP)</u> <u>is Market Competitive</u>

Q. What is the Commission Staff's view on PSE's levels of executive pay and the executive pay programs?

A. The Commission Staff did not recommend any adjustments to executive salary or to executive pay programs for retirement.

Q. What adjustments to Supplemental Executive Retirement Plan (SERP) costs were proposed by other parties?

A. Public Counsel witness James Dittmer and FEA witness Ralph Smith both recommended removing all SERP expense from PSE's revenue requirements.

Q. Mr. Dittmer recommends eliminating expense from the Company's SERP . What is the basis for his recommendation?

A. Mr. Dittmer gave three reasons: the participants are highly paid and entitled to normal benefits under the qualified retirement plan, the plan is expensive to offer because it is not tax efficient, and other Washington utilities are either no longer offering the benefit or do not seek rate recovery.

Q. Mr. Dittmer questioned whether the SERP plan was necessary because it provides "additional retirement benefits above and beyond that which are available to the highly compensated employees through the 'qualified' retirement plan." Is the SERP plan necessary?

A. SERP plans are a common feature at utilities and are necessary to attract and retain executives. Attached as Exhibit No. TMH-17C is a report by Towers Perrin that was presented to the Compensation and Leadership Committee of PSE's Board of Directors on November 3, 2009 and was provided to Public Counsel as confidential Attachment A to PSE's Response to Public Counsel Data Request No. 525. Mr. Dittmer referred to this report in his testimony beginning at page 61 and pointed out that of [redacted] participating companies "[redacted]." Even according to Mr. Dittmer's count, [redacted] of [redacted], or 83% of peer companies provide supplemental retirement programs. Towers Perrin reached the same conclusion in page 5 of the report, "[redacted]. [redacted]."

SERP plans are necessary to provide retirement benefits to executive employees that replace income at the same proportions as non-executive employees. The "additional retirement benefits above and beyond" mentioned by Mr. Dittmer are not higher proportions of income earned. As described in my initial testimony, without SERP plans, a mid-career executive would lose retirement value if transferring mid-career to a company without a SERP.

Q. How many of PSE's current Officers could be considered mid-career transfers?

A. Of PSE's twelve Officers as of November 30, 2009, seven joined since January 2002 and can be considered mid-career transfers.

Q. Mr. Dittmer labeled the SERP plan as expensive to offer because it does not provide the same tax advantages of the qualified retirement plan. What is PSE's response?

A. SERP plans and other deferred compensation plans are subject to regulation by the Internal Revenue Service (IRS) and do provide tax deductions to PSE when benefits are paid. One aspect where qualified plans are more tax efficient is that the plans' assets are allowed to earn income and grow without PSE being taxed. This significant advantage of the qualified plans is not available to the SERP plan, and helps explain the seeming disproportion of expense that Mr. Dittmer raises at pages 62 and 63. The qualified plan's large actual benefit payments are offset for accounting purposes by large actuarial assumed gains from the pension plan's $400 million of assets. Without such assets and assumed gains, the SERP payments appear large in comparison, but the full level of qualified benefit payments is not seen on Mr. Dittmer's Table VII.

Q. Are SERP plan payments discriminatory as Mr. Smith and Mr. Dittmer appear to argue?

A. Calling SERP plans discriminatory is a misnomer. Executive retirement plans exist to provide retirement security to executives and must comply with IRS rules for "non-qualified" plans, including IRS Section 409A. These specialized retirement plans have formulas that are not capped by the limits of "qualified" retirement plans, but they also lack the protections of "qualified" plans. Non-qualified retirement plans are not protected by the Pension Benefit Guaranty Corporation, and in the case of a company bankruptcy, the executive would likely not receive any payments. In fact, for non-qualified plans to comply with IRS rules and remain tax-deferred until payment, they must have a "significant risk of forfeiture."

Q. Did Mr. Dittmer or Mr. Smith include explanation for the reasons why companies would offer SERP plans?

A. Yes, in part. On page 25, Mr. Smith mentioned reasons for the programs in context of a company's qualified pension plan and limits imposed by those plans. Mr. Dittmer did not include explanations for the programs, and instead on page 61 described the SERP plan as "additional retirement benefits above and beyond that which are available to the highly compensated employees through the 'qualified' retirement plan."

Q. Why does the Company offer the SERP and Deferred Compensation Plan to executives?

A. My prefiled testimony summarized that PSE offers the SERP because it is part of the market competitive package needed to attract and retain executives and elaborated how the SERP's plan design accomplishes executive attraction and retention. "Because traditional retirement plans accrue more value at the end of an employee's career, executives would lose retirement plan value if they left mid-career and did not have a SERP at the new employer. The retention aspect of the SERP is due to its five-year vesting period, so an executive has an 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, executives are incented to stay until 15 years of service." *See* Exhibit No. TMH-1T, page 17, lines 17 and following.

Q. Mr. Dittmer mentioned at least one Washington company did not seek rate recovery of SERP while another had closed their SERP Plan. Mr. Smith's testimony documented four Arizona utilities there were denied rate recovery for SERP. How are these examples relevant to PSE's Rate Case?

A. The examples from other companies and other regulatory jurisdictions provide additional data that SERP programs are widely used in the utility industry, even if regulatory jurisdictions outside Washington have chosen not to include the expense in rates. The examples also highlight the importance of prior statements the Washington Commission has made about total compensation, namely "[t]he ultimate issue is whether total compensation is reasonable and provides benefits to ratepayers, not whether incentive compensation is paid in stock or whether compensation, particularly for executives, is similar to that of other comparable companies." *See* Docket UE-050684, Order 4; UE-50412, Order 3, page 49, paragraph 128. Multiple elements combine to form total compensation, and comparing simply on one element, such as SERP, can be misleading. For example, Mr. Dittmer testifies that PacifiCorp's SERP plan has one active participant and currently is closed to new participants. He does not add that PacifiCorp's defined benefit plan's cash balance formula provides additional contributions to employees with salaries above $106,800 per year in 2009. PacifiCorp's defined benefit pension would provide larger benefits than PSE's cash balance formula for executive level employees, especially during mid-career.[3]

Q. Why should the Washington Commission agree to include SERP expense in the revenue requirement of this case?

A. The Commission should agree to continue including SERP in the revenue requirement for PSE because the benefit is part of the Company's market

[3] PacifiCorp's 2008 10-K form at page 123 states: "Under the cash balance formula, benefits are based on 6.5% (5% for employees hired after June 30, 2006 and before January 1, 2008) of eligible compensation plus 4.0% of eligible compensation in excess of compensation subject to Federal Insurance Contributions Act withholding ($102,000 for 2008) to each participant's account (where such salary and incentive amounts are reduced for Internal Revenue Code §401(a)(17) limits)." A PacifiCorp executive with $245,000 of compensation in 2009 would have a contribution of $21,453 to the plan – 6.5% of $245,000 plus a contribution of 4% of $138,200. A PSE executive with $245,000 compensation and age 40-49 would have a qualified contribution of $12,250-- 5% of $245,000. In this example, the PacifiCorp pension contribution would be 175% of the PSE contribution.

competitive retirement program and provides for attraction and retention of executive employees, which is a benefit for customers. The SERP has been part of PSE's revenue requirements for the past several years. Both the Company and Commission Staff calculated this adjustment in a similar manner as prior proceedings' treatment of SERP expense. Exhibit No. TMH-17C, shows over 80% of PSE's peer companies offer supplemental executive retirement plans, with most ([redacted]) using the same type of benefit as PSE. My testimony above has described the attraction and retention features of the SERP, which benefit customers as well as important aspects of the program that neither Mr. Dittmer nor Mr. Smith addressed.

Q. Are PSE's revenue requirements for executive compensation consistent with prior rate cases?

A. Yes. PSE's revenue requirements for executive compensation in the current rate case are consistent with prior rate cases. The Company has not requested customers pay for any elements of executive pay that were not previously included in rates, and in fact has voluntarily excluded officer incentive payments for this rate case.

III. REBUTTAL OF WAGE AND EMPLOYEE BENEFIT FLEX CREDIT ADJUSTMENTS

Q. What adjustments do Public Counsel witness Dittmer and Washington Commission Staff witness Huang propose to wage increases and employee benefit flex credit increases?

A. They recommend removing negotiated union wage increases, forecast non-union merit increases, and propose unusual wage offsets due to the current difficult economy.

Q. Does PSE agree with their recommended adjustments?

A. PSE does not agree with their recommended adjustments.

Q. Public Counsel witness Dittmer challenges the "known and measureable" status of wage and employee benefit flex credit adjustments. Does your testimony address the regulatory treatment of these expenses?

A. No. The testimony of PSE witness John H. Story addresses the topic of "known and measureable" increases. My testimony describes why PSE's proposed changes are needed to remain competitive in the market, which is essential to attract and retain a skilled, committed workforce that benefits ratepayers.

Q. Mr. Dittmer in his testimony on page 45, lines 10-11 shows an IBEW increase of 3% on January 1, 2009 and an "estimated" IBEW increase of 3% on January 1, 2010. Is this correct?

A. No. IBEW had an increase of 3.25% on April 1, 2009, as shown by Mr. Dittmer on line 9 of his testimony. The next IBEW contractual increase is a 3% increase on January 1, 2010 as contractually agreed to by PSE and the IBEW in 2007.

Q. Is this increase estimated, or is it a contractual requirement?

A. It is a contractual requirement. It is not an estimate.

Q. How would you characterize the proposed wage and employee benefit flex credit adjustments proposed by PSE?

A. I would characterize both the wage increases and employee benefit flex credit increases proposed by PSE as market competitive and reasonably sized to preserve PSE's competitive pay position. Utility increase market data for non-union employees was provided in Exhibit No. TMH-3C of my prefiled testimony. An updated version with forecast figures for 2010 is attached as Exhibit No. TMH-18C, showing that utility salary increases are still projected to exceed 3%. The benefit flex credit increase amount PSE planned for January 1, 2010 has been reduced from the initial 8.0% to the negotiated 4.75% increase amount, which has been communicated to employees during benefits open enrollment.

Q. In Mr. Dittmer's testimony, he recommends that the Commission should disallow some wages because of "offsets" he feels that PSE should be getting via productivity increases. Do you agree with his recommendation?

A. I do not agree with the wage offsets proposed by Mr. Dittmer. Wage increases are inappropriate for the type of offsets proposed. On pages 7-8 of his testimony, Commission Staff Witness Parvinen describes examples of appropriate known and measurable changes, including negotiated wage contracts. Mr. Parvinen's testimony at page 7 outlines the key concept: "Similarly, a union wage increase for certain of the utility's employees that is called for by a collective bargaining agreement likely would not be offset by other factors, if it would not affect the number of hours worked during the test period." Mr. Dittmer's use of the offset concept erroneously assumes that PSE's work has been static, meaning that increased productivity reduces hours. PSE employees (all utility employees) have had new demands placed on them by increased regulations, compliance, and the ongoing work of system replacement. The key phrase used by Mr. Dittmer was one he italicized in his testimony at page 20, "*All other things being held constant*, a 3% increase in the employee group's wages would translate into a 3.00% increase in the cost of the good or service being produced by the employee group. However, if the employee group can in some way become 3.00% more efficient than it has been previously, the cost to the purchaser of the goods or service provided by the employee work group would remain constant notwithstanding the 3.00% wage increase per hour worked that was authorized for the employee group." PSE employees have become more productive, and that productivity translates into additional productive capacity to do other work required by increased regulations, compliance and ongoing system replacement, not spending less time doing a static set of assembly line tasks for ratepayers. The employees addressed by Mr. Dittmer's offset are supporting the regulated utility 100% and to propose not having the ratepayers pay for the cost of their labor is improper.

Q. Mr. Dittmer's testimony suggests that increases in productivity should result in decreases in employer's costs for wages. Do you agree?

A. No. Data from the Bureau of Labor Statistics attached as Exhibit No. TMH-19 indicate that as worker productivity, measured as output per hour, increases, the Employer Cost Index ("ECI") also increases.

Q. Ms. Huang's testimony indicated at page 5 that PSE double counted IBEW wage increases during the period January 1, 2010 to March 31, 2010. Is this correct, and do you agree with Ms. Huang's resulting adjustment?

A. Ms. Huang's adjustment is not correct because there is not double counting within the IBEW wage increases. The 2007 contract between the IBEW and PSE included a 3.25% wage increase effective April 1, 2009 and a subsequent increase on January 1, 2010. The second negotiated increase occurs less than 12 months from the first; however it is not double-counting. PSE and the IBEW desired to have the effective date of wage increases shift from April 1st as in prior contracts, to a January 1st date, effective with 2010. Ms. Huang has erroneously removed the contractually obligatory increase of 3.0% on 1/1/2010, a rate of pay, which would continue throughout 2010.

Q. What specific adjustments did the parties propose with respect to PSE's employee benefit flex credit increases?

A. Mr. Dittmer proposed disallowing any increase in PSE's employee benefit flex credits, because he argued that the initial 8% increase was not known and the contracted 4.75% rate for 2010 was negotiated after the filing date of this rate case. Ms. Huang proposes using the contracted 4.75% rate instead of the original 8.0% rate.

Q. Why was 8% initially proposed by PSE as the flex credit rate?

A. PSE's initial budgeted flex credit increase rate was 8% because that was the same value for 2009 in the prior IBEW and UA contracts, medical cost trends were unclear at the time of filing the rate case, and PSE knew it would be negotiating the single issue of flex credit rates with each union. The prior contracted flex credit increases at been 8%, 8%, 8%, 10%, 10% and 10% spanning back to 2003/2004.

Q. Did the 4.75% rate negotiated with the IBEW and UA unions mean that the health care cost trends had changed?

A. PSE's ability to renew the 2010 flex credit rates at 4.75% was not due to a fundamental change in health care cost trends. During negotiations with the union, the general industry trend of health care increase was approximately 6%. However, PSE's health plan renewal rates for 2010 were available during the single item negotiation and because of favorable PSE claim experience and a competitive market for insurance renewal quotes, PSE and the unions were able to agree that a 4.75% flex increase would allow employees to face only small premium contribution increases. PSE agrees with Ms. Huang's proposal to use 4.75% for the rate increase applied to rates.

IV. CONCLUSION

Q. Do you think that the Company's treatment of executive pay and wage and benefit credit adjustments are appropriate?

A. Yes. PSE's recommended treatment of executive pay is consistent with prior guidance and provides customers with the benefit of capable company leadership. PSE's recommended treatment of contracted union wage and benefit increases and planned non-union merit pay increases are consistent with prior rate cases and benefit the customer by keeping a stable employee base.

Q. Does that conclude your prefiled rebuttal testimony?

A. Yes.