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BEFORE THE WASHINGTON UTILITIES &
TRANSPORTATION COMMISSION

DOCKET NO. UE-991606
DOCKET NO. UG-991607

REBUTTAL TESTIMONY OF KAREN S. FELTES
REPRESENTING AVISTA CORPORATION

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1 Q. Please state your name, business address, and present position with Avista
2 Corporation.

3 A. My name is Karen S. Feltes. My business address is East 1411 Mission
4 Avenue, Spokane, Washington. I am employed by Avista Corporation (the Company) as
5 the Senior Director of Human Resources.

6 Q. Would you please describe your education and business experience?

7 A. I graduated from the University of Washington with a Bachelor of Arts
8 Degree in Communications with concentrations in Public Relations and Journalism. I went
9 on to receive my M.B.A. from Seattle City University. Prior to joining the Company in
10 1998, I have had a career in human resources for 20 years. Over the past 10 years I held
11 various senior level HR management positions in both public and private industry,
12 including King County and Microsoft. I have had formal training by the American
13 Compensation Association in the areas of executive compensation and international
14 compensation programs. I am currently a member of the American Compensation
15 Association as well as a member of the Society for Human Resource Management.

16 Q. What are your responsibilities as Senior Director of Human Resources?

17 A. I have accountability for all areas of human resources for our corporation.
18 This includes compensation, benefits, payroll, employee relations and labor relations,
19 employment, and policy oversight.

20 Q. Have you previously testified before this Commission?

21 A. No.

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

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A. My testimony in this proceeding will cover policy regarding Avista's compensation programs.

Q. Do you agree with Staff's assertion that the CEO's compensation is pegged to the competitive marketplace, and therefore is not appropriate compensation for a regulated utility such as Avista?

A. No. Executive officer compensation should assist in attracting and retaining key executives critical to long-term success. To that end the Company's philosophy is that the total compensation program should consist of an annual base salary, an annual incentive and long-term incentives. The Company considers but does not target executive officer compensation at the median of similarly situated executives. In order to hire, reward and retain the most competent executives the Company must provide compensation opportunities reflective of the marketplace. Our total compensation philosophy supports the Company's goal to be an industry leader in performance, value and service. Our philosophy aids our ability to attract and retain the people we need to drive and sustain our organization's performance. The Company's overall executive compensation is set at a reasonable level.

Q. What ratepayer benefit is derived from the Company's total compensation program?

A. Ratepayers benefit from effective and capable utility management through innovation, efficiencies and leadership on strategic initiatives. In order to attract such management, it is necessary to provide a compensation package (base salary/bonuses/stock options/restricted stock) that will be competitive in a national hiring market. We are, after

1 all, competing for talent in a much broader market than just the State of Washington.

2 A prime objective of our compensation strategy is to be competitive within hiring
3 markets. We market price our jobs and compile extensive survey sources as a basis for
4 setting our compensation levels so that our positions are priced consistent with comparable
5 market levels. We compete for talent at all levels against both regulated and non-regulated
6 entities.

7 Q. Is the CEO compensation analysis performed by Witness Huang valid?

8 A. No. Staff based their determination on only one source of information. Staff
9 asserts that the CEO's base salary should be placed at the 50th Percentile for companies
10 with \$1B to \$3B of revenues. Typically, a CEO's base pay is evaluated using total
11 corporate revenues as but one guide for targeting a range of base pay. Such studies can help
12 assess placement but other factors are critical when creating an actual offer. We must
13 consider who can do the job, their current earnings and tenure with their company, and the
14 value that their experience will bring to our business. We use the study data to assure we
15 are within reasonable boundaries for our industry, but must customize our offer to incent the
16 prospective employee to join our organization. The success of our company depends
17 largely on the talent we can attract. Top talent creates greater efficiency and productivity,
18 ultimately providing the best service to our customers.

19 Q. Do you agree with Staff's labeling of signing bonuses and restricted stock
20 compensation as benefiting solely the non-regulated side of the operation?

21 A. No. Signing bonuses and restricted stock awards are used for retention and
22 attraction of qualified candidates. These elements are also part of what we term a total

1 compensation package, with base pay being only one component of the total compensation
2 package. Restricted stock, which vests through time, is used as an immediate retention
3 strategy. These same components are part of the compensation package that is necessary to
4 attract the right candidates to our organization. (The signing bonuses and restricted stock
5 awards vest over the term of the employment contracts and encourage a long-term executive
6 focus. It is appropriate to include these as part of the compensation for all three executives
7 named. The Towers and Perrin study shows that publicly traded regulated utilities
8 commonly use stock awards in their compensation programs.

9 Q. Is Public Counsel's comparison of Avista's executive leadership to a PUD's
10 general manager a valid comparison?

11 A. No. Publicly traded companies require a different skill set from leadership.
12 For example, more complex interactions with the financial markets is required. One of the
13 first steps in salary analysis is identifying the industry(ies) within which we compete for
14 talent. To compare the salary of a corporate executive to an elected official or to a PUD
15 general manager is inappropriate based upon industry difference and the skill sets required.
16 In most cases we would not recruit from the public sector or from PUD's when searching
17 for executive officers due to industry variances in job accountabilities. Without diminishing
18 the contributions of managers to their respective PUD's, Avista is looking for a different
19 skill set when recruiting for top positions.

20 The utility business in general has changed dramatically over the past 10 years. Due
21 to an increase in acquisitions and mergers and varying levels of state deregulation, publicly
22 traded utilities have had to change strategies to survive and thrive. Avista serves gas and

1 electric in multiple states adding levels of business complexities not faced by PUD
2 management.

3 Additionally, the job market for all levels is dramatically different today than it was
4 10 years or even 3 years ago. The supply of competently qualified candidates is decreasing
5 while at the same time the number of positions requiring higher level skills and broader
6 experience is increasing. Highly qualified candidates today can pick and choose from
7 several job offers, making it more difficult to structure a compelling offer that will attract
8 the right candidate.

9 Q. Is it reasonable for staff to disallow the total amount for team incentives for
10 1998?

11 A. No. The 1998 incentive plan was designed to focus more on corporate goals
12 with ties to department goals. Under that umbrella, each department designed specific
13 customer service goals consistent with our overall corporate goals of increased efficiency
14 and customer satisfaction. (Please refer to witness Mitchell for additional discussion of the
15 1998 plan.)

16 Our overall compensation philosophy includes “pay for performance”. Incentive
17 compensation is a valuable tool to increase employees focus on immediate goals that
18 support overall quality customer service and operational efficiencies. The incentive plan is
19 a vehicle for communicating strategic priorities that are then translated into tactical goals. It
20 focuses employees on achieving desired results while at the same time promoting actions
21 that are consistent with underlying business plans. It supports the message that employees
22 can have an impact on our annual success as a company. Although the design of the

1 incentive plan will vary from year to year based upon business needs, the overall message to
2 employees is that we link pay to performance and set annual targets that are measurable.

3 Q. Do you agree with Mr. Lazar's assumption that salary increases should not
4 exceed growth in CPI?

5 A. No. It is not reasonable to assert that the only relative index to use when
6 evaluating salary increases is the rate of inflation unless all salaries in the U.S. labor pool
7 are subject to the same limit. The American Compensation Association Report on 1999-
8 2000 Total Salary Increase Budget Survey states that with few exceptions, salary increases
9 surpassed inflation rates by a significant amount. Salary increases for 1999 for the United
10 States were on average 4.4% whereas the inflation rate was 1.7%. Even Washington State
11 minimum wage has out stripped inflation between 1984 and 1998. (Please refer to Witness
12 Mitchell's testimony for further discussion regarding Mr. Lazar's analysis.)

13 Q. Any concluding remarks?

14 A. I would like to summarize some key points:
15 Executive compensation strategies have evolved significantly in recent years with
16 greater emphasis on bonuses and incentives as recruitment and retention tools.
17 Company management and elected Board members should be given some discretion
18 in matters related to executive compensation and broad based incentive plans, as
19 they chart the future strategic direction of the company in a rapidly changing
20 environment.

21 Q. Does that conclude your direct testimony?

22 A. Yes, it does.