Exhibit No.___(EDW-3T)
Docket No. UE-100749
Witness: Erich D. Wilson

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, vs. PACIFICORP dba Pacific Power Respondent.	)	Docket No. UE-100749

PACIFICORP

REBUTTAL TESTIMONY OF ERICH D. WILSON

November 2010

Q. Are you the same Erich D. Wilson that previously provided testimony in this docket?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to explain why the Commission should reject certain labor related adjustments proposed by the Industrial Customers of Northwest Utilities (ICNU) and Public Counsel witness Mr. Greg Meyer, and by ICNU witness Mr. Randall Falkenberg. Specifically, I demonstrate:

- The Company's incentive program is not a "bonus," is structured to provide benefits to customers consistent with Commission precedent, and is part of the Company's total market-based compensation package. The removal of incentive expense would therefore result in below-market compensation.
- The 2009 base wage expense was reasonable and consistent with the competitive market in which the Company competes for labor.
- The 2010 base wage expense is based on known and measureable changes.
- There is no basis for removing management bonuses and employee meals and gifts at the Jim Bridger Plant; the amounts in this case represent recurring amounts for these elements of the reasonable costs of doing business.

Q. Has the Company accepted any of Mr. Meyer's labor-related adjustments?

A. Yes. The Company has removed expenses associated with the supplemental executive retirement program (SERP). This adjustment is discussed in the rebuttal testimony of Company witness Mr. R. Bryce Dalley.

Compensation Philosophy and Background

Q. Please briefly review the Company's compensation philosophy.

A. As I explained in my direct testimony, the Company's primary objective in establishing employee compensation is to provide pay at the market average. Compensation at the market average (competitive level) is critical to attracting and retaining qualified employees to support the business and our customers.

I also explained in my direct testimony that the Company's view is that, in order to encourage superior performance, a certain percentage of each employee's market compensation must be "at risk." The Company's Annual Incentive Plan is structured so that each employee has the opportunity to receive total compensation at the market average, so long as the employee performs at an acceptable level. In exceptional performance years, an employee's incentive may be more than target and in low performance years may be below target, but on average, the incentive is generally at the guideline level. If the individual fails to earn the full guideline incentive, that individual will be paid less than the competitive total cash compensation in the marketplace for that year. Central to the Company's approach to total compensation is that, while certain employees may be paid more than or less than market in a given year as a result of the incentive portion of compensation, on an overall basis the base compensation and incentive will result in a level of compensation commensurate with the market. Stated another way, in the unlikely event every employee performed at exactly the same level, each employee would be paid only at the market average.

Q. Did ICNU propose to disallow incentive payments in PacifiCorp's last fully litigated rate case, Docket UE-061546?

A. Yes. ICNU proposed to disallow all executive incentive payments and 50 percent of non-executive incentive payments. The Commission rejected ICNU's argument that payments under PacifiCorp's incentive program were tied to business and financial performance.[1] The Commission found that the Company's argument that objectives were related primarily to operational effectiveness, customer satisfaction, and safety was persuasive and supported by the record.

Q. Has the Company's general compensation philosophy and approach changed in any material way since the time of this decision?

A. No. Since MidAmerican Energy Holdings Company (MEHC) acquired PacifiCorp in 2006, PacifiCorp's compensation philosophy and approach have remained constant. It is essential to also recognize that, since the change in ownership to MEHC, the Company has adjusted its approach on incentive compensation to only seek recovery at the market level, which aligns with Commission direction. This is in contrast to the approach under Scottish Power ownership, where the company included all incentive compensation expense in filings and in many years the award and in turn expense requested was above the market average.

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[1] *Wash. Util. & Transp. Comm'n v. PacifiCorp,* Docket No. 061546, Order 8 at 46-47 (June 21, 2007).

Incentive Compensation

Q. Please describe Mr. Meyer's proposed adjustment to the incentive portion of PacifiCorp's total compensation package.

A. Mr. Meyer proposes to remove 50 percent of the incentive portion of the compensation package, resulting in a $0.7 million disallowance on a Washington-allocated basis. Mr. Meyer bases this recommendation on a faulty conclusion that the goals used to measure performance under the incentive plan are not well defined, are hard to quantify, relate to normal duties of an employee's job, do not motivate the employees, and may enhance shareholder value.

Q. Do you agree with Mr. Meyer's proposed adjustment?

A. No. Mr. Meyer's adjustment would exclude legitimate costs of the total compensation package that he has not demonstrated to be unreasonable or imprudent. From an overall standpoint, reducing incentive costs will result in employees being underpaid. As I explained in my direct testimony, incentive pay is not "extra pay" or a "bonus." Rather, incentive pay is an integral portion of a competitive level of pay.

Over the past few years, there has been a significant shift by companies to deliver compensation in the form of both base pay and incentive. This compensation structure allows the company to place emphasis on employee performance in areas critical to employees and customers such as safety, reliability, and customer service. Customers clearly benefit when employees are incentivized to focus on these activities.

It is critical to understand the "at risk" portion of total compensation is not a bonus. A bonus is something unexpected. The “at risk” compensation is not unexpected—in fact, it is the opposite. The “at risk” portion of total compensation is expected by the employee but only if the employee performs at or above an acceptable level. Any reduction beyond the competitive target incentive level would place the Company in a position of not being able to offer competitive pay levels and placing operational and customer objectives at risk.

Q. Please explain the framework the Commission has used to evaluate whether incentive compensation is reasonable.

A. In PacifiCorp Docket UE-050684, the Commission stated that “The ultimate issue is whether total compensation is reasonable and provides benefits to ratepayers.”[2] My testimony explains why the Company’s incentive program continues to meet both criteria.

Q. Has Mr. Meyer alleged that the Company’s overall level of compensation is unreasonable?

A. No. Mr. Meyer attacks the incentive portion of the total compensation but does not allege that the Company’s total level of compensation is unreasonably high compared with the market. It would appear that if the Company proposed the same total level of compensation but structured it as purely base compensation, Mr. Meyer would not have a basis for adjusting the overall level of compensation, with the exception of the limited adjustments I address below.

[2] *Wash. Util. & Transp. Comm’n v. PacifiCorp*, Docket UE-050684, Order 3 at 48 (Apr. 17, 2006).

Q. Is a compensation structure that includes an incentive element to reach competitive pay levels consistent with Commission policy?

A. Yes. The Commission previously noted that it will defer to market realities for utility employee salaries if they appear to be reasonable.[3] The Company's level and structure of compensation reflect the market-based shift in compensation philosophy that I discussed above and an overall level of pay that is at the market average. Inasmuch as the Company's compensation structure is designed to reflect market realities and is reasonable, the Commission should reject Mr. Meyer's criticisms.

Q. Mr. Meyer criticizes the Company's incentive program on the basis that it improves shareholder value. Has the Company tailored its goals to benefit shareholders?

A. No. On the contrary, the Company's focus in setting goals is to improve operational efficiency, improve customer service, and promote safety, all of which benefit customers and have been acknowledged as legitimate goals of an incentive program by the Commission.[4] The annual goal setting process begins with discussions between the manager and employee in order to ensure that the employee establishes goals that align with the business and operational objectives for the year. The goals are then documented with assigned measurements. The goals do include controlling expenses, because employees can reasonably be expected to control costs, which benefits customers. The goals associated with

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[3] *Wash. Util. & Transp. Comm'n v. Avista*, Docket UE-991606, Third Supplemental Order at 72 (Sept. 29, 2000).
[4] *Wash. Util. & Transp. Comm'n v. Wash. Natural Gas Co*., Docket UG-920840, Fourth Supplemental Order (1993).

this compensation do not include net income or revenues for most employees because most employees are not in a position to impact revenues. The Company has a separate plan, the Long-Term Incentive Plan (LTIP), that contains goals related to net income and revenue for those employees best in a position to impact those elements.

Since placing a portion of total compensation at risk, the Company has seen improvements in safety, customer service standards, and operational output. These outcomes demonstrate that the Company's approach has been successful in motivating employees in a way that results in customer benefits. While these achievements may provide indirect benefits to the shareholder, that is not the guiding principle in how the program is designed.

Q. Has the Company proposed including in rates costs related to its LTIP?

A. No. The Company's LTIP is a separate plan for executives that awards bonuses based on overall corporate performance, including revenues and net income. The Company does not ask customers to absorb the costs associated with that plan.

Q. Do you agree with Mr. Meyer that the Commission's policy has been to reject incentive programs that primarily benefit customers but could provide indirect benefits to shareholders?

A. No. It is my understanding that the Commission does not allow recovery for incentive plans that are based on meeting net income and other financial goals. However, the Commission includes as acceptable goals of incentive programs those that could provide indirect benefits to shareholders. The Commission explained in PacifiCorp Docket UE-050684 that it has "allowed in rates payments under plans that have a dual benefit—to shareholders and ratepayers" under certain circumstances.[5] For example, controlling costs, providing good customer service, and promoting safety[6] clearly provide direct benefits to customers, but also provide indirect benefits to shareholders. The Company's incentive program is consistent with the Commission's policy of setting goals that clearly and directly benefit customers, such as controlling costs, promoting energy efficiency, providing good customer service and promoting safety.

In addition, the Commission has never found that incentive programs must be limited to goals that "improve or maintain PacifiCorp's existing operational performance" as Mr. Meyer proposes. Limiting the incentive program in that way would ignore other important benefits to customers, such as cost control, customer service, and safety.

Q. Mr. Meyer claims that the group goals are ineffective because they do not provide employees with the quantitative goals to assess their performance and provide for subjective evaluation by the manager. Do you agree with these criticisms?

A. No. First, let me emphasize that every employee has individual goals, not just goals for the group to which the employee belongs. Second, shared group goals can be effective and quantifiable, such as goals related to safety or customer service. For example, Exhibit No.___(EDW-4) shows the 2009 objectives of an Engineer. One of these objectives includes "OSHA Incident Rate – Maintain a

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[5] *Wash. Util. & Transp. Comm'n v. PacifiCorp*, Docket UE-050684, Order 3 at 48 (Apr. 17, 2006).

[6] *Wash. Util. & Transp. Comm'n v. Wash. Natural Gas Co*., Docket UG-920840, Fourth Supplemental Order (1993).

safe work environment for employees – Ensure Hydro Resources has 3 or less incidents in 2009, which will allow Hydro to achieve an incident rate of 1.6 or less." Clearly, achievement of this goal can be measured based on the number of incidents that occur at hydro resources. Not every indicia of performance, however, is quantifiable. For example, Exhibit No.___(EDW-4) also shows as one of this employee's goals "Coordinate all work that has any potential environmental impacts with the area environmental analyst. Consider any impact as far as oil spills, fish (ramping, minimum flow), PBC, asbestos, or any other related environmental issues in advance for all the overhaul projects and make the appropriate parties aware." This goal, although not quantifiable, is designed to motivate employee behavior that will provide benefits to customers. Mr. Meyer's "quantifiable" argument should be disregarded. Moreover, PacifiCorp has found that, as long as goals are specific, concrete, and observable, allowing for some management discretion in making awards creates a more powerful motivator for superior performance.

Q. Mr. Meyer appears to argue that the fact that not all goals are quantifiable will result in employees not understanding the goals. Do you agree?

A. No. In my experience the Company's employees generally understand their respective goals and work towards fulfilling them. In fact, imposing a "quantifiable" requirement on employee goals would result in confusion among employees who have goals that are inherently unquantifiable, such as the goal set forth in Exhibit No.___(EDW-4).

Q. How do you respond to Mr. Meyer's argument that some of the Company's performance factors should be classified as job requirements?

A. Mr. Meyer misperceives the "at risk" portion of total compensation as a bonus. As I have explained, it is not. Recognizing this, Mr. Meyer's criticism is, in fact, an acknowledgement that the Company has designed its total compensation correctly. Only by performing the job requirements at acceptable levels can the employee achieve total compensation at the market average.

As I have explained, because the Company's compensation structure includes incentive payments as part of market compensation, employees meeting their goals should receive a level of base and incentive compensation consistent with market compensation. It is logical, then, that the employee's goals will set forth what acceptable job performance is for that employee. Employees exceeding these goals should receive additional incentive compensation to encourage exemplary performance.

Q. Using the example that Mr. Meyer cites related to the goal of "act[ing] with integrity by demonstrating professional, courteous, ethical and fair behavior at all times," can you explain how an employee could exhibit exceptional job performance with respect to that requirement?

A. While the Company certainly expects fair courteous and ethical behavior on the part of all of its employees, an employee could fulfill his or her job performance in a way that exceeds a baseline standard of courteous and ethical behavior. For example, an employee who provides assistance or mentoring to other employees beyond what would normally be expected, or who remains courteous when faced with an unusually difficult conflict could be considered to exceed the goal that Mr. Meyer references.

Q. Do you have any further observations about Mr. Meyer's criticism of the Company's goals?

A. Yes. Mr. Meyer's arguments are narrowly focused on one element of an individual's performance, that being the performance against the six defined common goals. It is important to note that these six goals comprise only 30 percent of employees overall evaluation. Detailed descriptions of these goals are included as part of my direct testimony. Even if Mr. Meyer's criticisms of a small proportion of employee goals were accurate, it is an insufficient basis for removing 50 percent of incentives.

Q. Do you believe that Mr. Meyer has presented a basis for disallowing any portion of the Company's incentive program?

A. No. The Commission has stated that it "generally does best by leaving incentives to management as one of the appropriate tools for operating a business."[7] The Company has developed an incentive program that is directly tied to customer goals, has provided demonstrable benefits to customers, and is part of an overall compensation package that is commensurate with the market. The Company requests that the Commission reject Mr. Meyer's proposed adjustment.

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[7] *Wash. Util. & Transp. Comm'n v. US West,* Docket UT-950200, 15th Supplemental Order at 47-48, 169 P.U.R.4th 417 (Apr. 11, 1996).

2009 Base Wages

Q. Please describe Mr. Meyer's proposed adjustment to the 2009 wage increase level.

A. Mr. Meyer proposes to recalculate the 2009 wage increase level for the Officer/Exempt labor group from the 3.5 percent actual amount that was included in the filing to the average increase granted to other labor groups, including union groups. Mr. Meyer calculates this increase as 2.07 percent, resulting in a $179,951 decrease to Washington-allocated payroll.

Q. Do you agree with Mr. Meyer's proposed adjustment?

A. No. Mr. Meyer improperly calculates his adjustment using both union and non-union wage increases. Using wage increases for union to calculate the wage increase for a non-union group is unreasonable because the two employee groups are different in a variety of key compensation and benefit areas.

Q. Please explain why it is unreasonable to rely on union wage increases to calculate non-union wage increases.

A. PacifiCorp's union employees work through a collective bargaining process in which the negotiated agreement is comprised of many variables such as work rules—rest periods (paid/unpaid); call out provisions; medical benefits—cost sharing, plan provisions; and retirement funding—defined benefit versus defined contribution. As an example, IBEW 125, which is PacifiCorp's labor workgroup in Washington, still has a high percentage of its employees in a defined benefit plan, while this is no longer the case for the Officer/Exempt group. When negotiating labor agreements, the Company may offset more expensive benefits such as this one with a lower wage increase. These variables together deliver a competitive set of benefits and compensation to the union employee workgroup, however, in isolation, the union wage increases are not comparable to the non-union increases.

Q. Is the Officer/Exempt wage increase comparable with the other non-union group?

A. Yes. The average Officer/Exempt wage increase is the same as the average wage increase for the Non-Exempt employees—3.5 percent.

Q. Mr. Meyer argues that other utilities have limited the wage increases for their executives in 2009 and 2010. How do you respond?

A. I note that while the Officer/Exempt group includes the Company's top executives, the majority of this group is the salaried employees that comprise the Company's professional, technical, support, and middle management employees. Therefore, Mr. Meyer's argument that three utilities, one of which is apparently based in Missouri, have lower wage increases for their executives in 2009 and 2010 is not relevant to the vast majority of PacifiCorp's non-executive members of the Officer/Exempt group.

Q. How does the Company's 3.5 percent wage adjustment compare to the market in which it competes for labor?

A. As I have noted, the company annually does a thorough assessment of the market and reviews practices being undertaken by its competitors in the area of planned wage increases. Confidential Exhibit No.___(EDW-5C) shows the analysis completed and that the results for the 2009 plan year was an average increase of 3.75 percent as compared to the company's wage adjustment of 3.5 percent.

Q. Does the 2009 wage increases result in overall compensation that is higher than market?

A. No, and Mr. Meyer has not alleged that it does. The Company therefore requests that the Commission reject Mr. Meyer's proposed disallowance of known and measurable wage increases.

Q. Did the Commission recently reject an adjustment disallowing similar known and measurable wage increases?

A. Yes. In Avista Utilities' 2009 rate case, Public Counsel recommended adjusting the 2008 salaries paid to executives to the same increase received by administrative employees.[8] The Commission rejected the adjustment, finding that the Company had revised its salary data to represent amounts actually paid to officers and that Public Counsel presented "no compelling reason" to depart from that actual data.[9]

Similarly, for 2009, PacifiCorp has included only those salary increases that have already occurred and are therefore known and certain. The evidence is clear that the Company will be paying the proposed level of wages and salary. Mr. Meyer presents no compelling reason to depart from this actual data and his proposal should therefore be rejected.

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[8] *Wash. Util. & Transp. Comm'n v. Avista Corp.*, Docket UE-090134, Order at 44 (Dec. 22, 2009).

[9] *Id.* at 46.

2010 Wage Increase

Q. Please describe Mr. Meyer's proposed adjustment to the 2010 wage increase level.

A. Mr. Meyer proposes to eliminate the entire 2010 wage increase included in this case based on a view that the Company has not demonstrated that all relevant factors of the revenue requirement have been considered. He further argues that his disallowance should be supported as the Company has chosen to include one item of cost of service to increase the revenue requirement without examining all the operations of the Company to determine if there are corresponding offsets to the wage increase.

Q. Do you agree with Mr. Meyer's proposed adjustment?

A. No. As discussed in more detail in Mr. Dalley's direct and rebuttal testimony, only known and measureable 2010 wage increases are included in this case. As just noted, the Commission has allowed known and measurable adjustments for wage increases.

Q. Please describe the limited nature of the Company's 2010 wage increase.

A. The 2010 wage increases for non-represented employees were based on a detailed market analysis of the actions being taken in the labor market. From this assessment, and also factoring in the economic climate and conditions facing our customers, the Company implemented 2010 wage increases slightly below market practices and only those employees who received a base compensation below $100,000 were eligible for an increase. The wage increases for labor union employees were based on signed collective bargaining agreements.

Q. Does Mr. Meyer allege that the 2010 wage increases were imprudent?

A. No. Mr. Meyer does not object to the level of the 2010 wage increases, only that other adjustments should also be included in the revenue requirement. However, Mr. Meyer does not quantify these other adjustments or provide evidence in support of them. As a result, there is insufficient evidence supporting these adjustments and they should not be used as a basis for disallowing the known and measurable change to wages.

Employee Costs at the Bridger Plant

Q. Please explain ICNU's proposed adjustment related to employee costs at the Bridger Plant.

A. In the testimony of Mr. Falkenberg, ICNU proposes to remove $1.792 million on a west control area basis related to management bonuses, employee meals and gifts, and donations. Company witness Mr. Gregory N. Duvall explains ICNU's adjustment in more detail in his rebuttal testimony, but for purposes of my testimony ICNU's central argument is that low-quality fuel at the Bridger Plant results in derations that increase power costs and that management bonuses, employee meals and gifts, and donations should be removed until overall performance has improved.

Q. Is ICNU's proposed adjustment reasonable?

A. No. Mr. Duvall explains that when viewed as a whole, the fuel expense for the Bridger Plant is reasonable. Because Bridger management has acted prudently with respect to fuel at Bridger and ICNU presents no evidence showing that the cited employee costs are not reasonable, the Company believes that the

Commission should reject the proposed disallowance of employee costs related to the Bridger Plant.

Q. Does this conclude your rebuttal testimony?

A. Yes.