

**EXHIBIT NO. ___(TMH-1T)
DOCKETS UE-17___/UG-17___
2017 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,

Respondent.

**Docket UE-17___
Docket UG-17___**

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF

THOMAS M. HUNT

ON BEHALF OF PUGET SOUND ENERGY

JANUARY 13, 2017

PUGET SOUND ENERGY

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

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1 **PUGET SOUND ENERGY**

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

4 **I. INTRODUCTION**

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

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

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

11 A. Exhibit No. ___(TMH-2) describes my educational and professional experience.

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

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

- 16 • Reporting on human resources information;
- 17 • Employee health and welfare benefits for all active
18 employees (and retiree medical programs for retirees);

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- Retirement plans (Pension and 401k); and
- Short-term and long-term disability programs, ergonomics, job modifications and Workers Compensation.

I also analyze executive compensation programs and provide updates to the Compensation and Leadership Development Committee of the PSE Board of Directors. I report directly to the Senior Vice President and Chief Administrative Officer, who has overall responsibility for Human Resources in addition to other areas of PSE.

Q. Please summarize your testimony.

A. In my testimony, I describe the elements of PSE’s pay philosophy, which includes the compensation and benefit programs, and explain the steps that PSE has taken to compete in a challenging labor market while controlling wage and benefit costs. I also describe any significant changes made in program design since 2011, including those needed to comply with the Affordable Care Act. I show that PSE’s programs are market competitive with other utility companies and provide benefits to customers by enabling PSE to retain a skilled and engaged workforce.

1 **II. PSE’S STRATEGY FOR ITS COMPENSATION AND**
2 **BENEFIT PROGRAMS IS TO ATTRACT AND**
3 **RETAIN A SKILLED WORKFORCE**

4 **A. Pay Philosophy**

5 **Q. Please describe PSE’s pay philosophy.**

6 A. PSE’s pay philosophy has four main elements: (1) to provide a total compensation
7 view that includes salary, incentives, and benefits; (2) to pay competitively
8 compared to the utility market; (3) to pay-for-performance; and (4) to offer
9 employee choice. The pay philosophy is designed to attract talented new employees
10 and motivate existing employees to stay with PSE to develop and maintain their
11 experience in operating the utility. This provides business continuity and maintains
12 a high quality of work.

13 Taking a total compensation view allows PSE to communicate with employees the
14 balance of different rewards for working at PSE, rather than focusing on a single
15 element of compensation. By offering competitive pay, PSE can attract and retain
16 talented employees. When PSE is able to retain good employees it keeps costs
17 down, as PSE can minimize the high cost of replacing and training new employees.
18 Paying for performance is important in directing higher rewards to the strongest
19 performers, enhancing productivity and effectiveness, and motivating talented
20 employees to stay. Offering employee choice, predominantly in the benefits
21 programs, enhances the value of PSE’s pay package to employees by allowing them

1 to spend more or less for the coverages that best fit their needs, as well as offering
2 options with federal tax advantages.

3 **Q. How does PSE implement its total compensation philosophy?**

4 A. PSE implements its total compensation philosophy through employee
5 communications that begin when candidates are considering joining PSE and are
6 detailed on PSE's intranet. Candidates and employees are able to calculate an
7 estimate of their total compensation through an excel worksheet "Employment
8 Value – Total Compensation estimator." Employees access the calculator via the
9 PSE intranet; candidates are typically sent the calculator via email to help in
10 understanding PSE's offer of employment.

11 **Q. How does PSE implement its market competitiveness philosophy?**

12 A. PSE participates in market surveys of pay and benefits to look at company-level
13 competitiveness (for benefits) and job specific competitiveness (for annual salary
14 and incentives). PSE also receives information from surveys and third party
15 consultants on trends in compensation and benefits. Based on the results of the
16 market surveys and identified trends, PSE considers program changes and
17 individual market-based pay adjustments.

1 **Q. How does PSE implement its pay-for-performance philosophy?**

2 A. PSE implements pay-for-performance through merit increases (for non-represented
3 employees) and through its Goals and Incentive Plan, which is described in a later
4 section of my testimony. PSE's salary grade structure allows managers to set base
5 salaries of non-represented employees within the full range of labor-market rates.
6 An employee's position within the pay range ("Position in Range") depends upon
7 several factors including experience, skill, knowledge and performance.
8 Performance is evaluated annually for non-union employees, assessing individual
9 performance on goals and PSE's expected competencies. PSE managers and
10 supervisors reinforce pay-for-performance by rating an employee's performance and
11 using this rating and the employee's Position In Range to determine merit salary
12 increases.

13 **Q. How does PSE implement its employee choice philosophy?**

14 A. PSE implements employee choice primarily in the benefits programs, where more
15 than one plan choice is usually offered, with different employee costs. PSE also
16 implements employee choice through programs such as workforce flexibility, where
17 non-represented employees and supervisors agree on flexible work schedule
18 arrangements.

1 **B. Compensation and Benefit Trends**

2 **Q. What trends have you seen since 2011?**

3 A. Some of the trends in the compensation and benefit arena since 2011 are as follows:

4 1. Tighter labor market

5 The region's employment has recovered from the recession that began in 2008, with
6 the state unemployment rate dropping from 9.9% in 2010 to 5.4% in August 2016.

7 In the Seattle-Bellevue-Everett area, the unemployment rate has fallen even lower,
8 from 8.4% in 2010 to 4.0% in August 2016. The lower unemployment rates result in
9 more competition for qualified employees.

10 2. Health care costs growing faster than consumer inflation

11 Health care expenses have continued to grow faster than consumer inflation.

12 According to surveys by Willis Towers Watson (2016 Emerging Trends in Health
13 Care and 2015 Emerging Trends in Health Care), the underlying medical cost trend
14 has been a 5-8% increase per year, but because of employer plan changes, employer
15 costs have experienced an average increase per employee of approximately 4-5.5%
16 per year. Both the underlying trend and resulting increase per employee are
17 substantially higher than consumer inflation.

1 3. Utility companies making changes to pension plans

2 While utilities are still more likely to offer defined benefit pensions than most other
3 industries, more utilities have made changes to their pension plans. Towers Watson
4 reports that 20% of employers in all industries offer defined benefit pensions to new
5 employees, as compared to 55% of utilities and energy industry employers.¹ Many
6 companies have changed pension benefits for new employees, either adopting a
7 cash balance formula instead of a traditional pension formula, or closing the plan to
8 new employees, while existing employees continue to accrue a benefit.

9 **C. Salary Administration**

10 **Q. How have salaries changed at PSE during the test year?**

11 A. On March 1, 2016, non-union employees received an average of 2.91% merit
12 increases and an estimated of 3% increases effective March 1, 2017. PSE will
13 update the actual wage increase for March 1, 2017 during the course of this
14 proceeding once it becomes known. PSE employees represented by the United
15 Association of Journeymen and Apprentices of the Plumbing and Pipefitting
16 Industry of the United States and Canada (“UA”) union had a wage adjustment of
17 3.0% on October 1, 2014, 3.0% on October 1, 2015, and 3.0% on October 1, 2016,

¹ Brendan McFarland, *A Continuing Shift in Retirement Offerings in the Fortune 500*, WILLIS TOWERS WATSON INSIDER, at 1, 5 (Feb. 2016), available at

1 as stipulated in their contract which was ratified on January 17, 2014. Effective
2 November 1, 2014, employees represented by the International Brotherhood of
3 Electrical Workers (“IBEW”) union received a general wage increase of 6% and
4 some employees received additional market pay adjustments, as stipulated in their
5 contract which was ratified December 11, 2014. The November wage increase was
6 larger than typical because the prior wage increase for IBEW represented employees
7 was effective April 1, 2013. The IBEW represented employees also received a wage
8 increase of 2.75% effective January 1, 2016.

9 **Q. How do PSE’s wage increases compare to the region and the utility industry?**

10 A. PSE’s merit increases have been similar to those in the region and the utility
11 industry. For 2016, the utility market was projected to increase salaries by
12 approximately 3.0%. Exhibit No. ___(TMH-3C) contains proprietary market
13 research supporting this increase. PSE’s actual non-union increase of 3.0% is
14 consistent with market data. PSE’s union wage increases are determined pursuant to
15 collective bargaining contracts and were lower than in prior contracts.

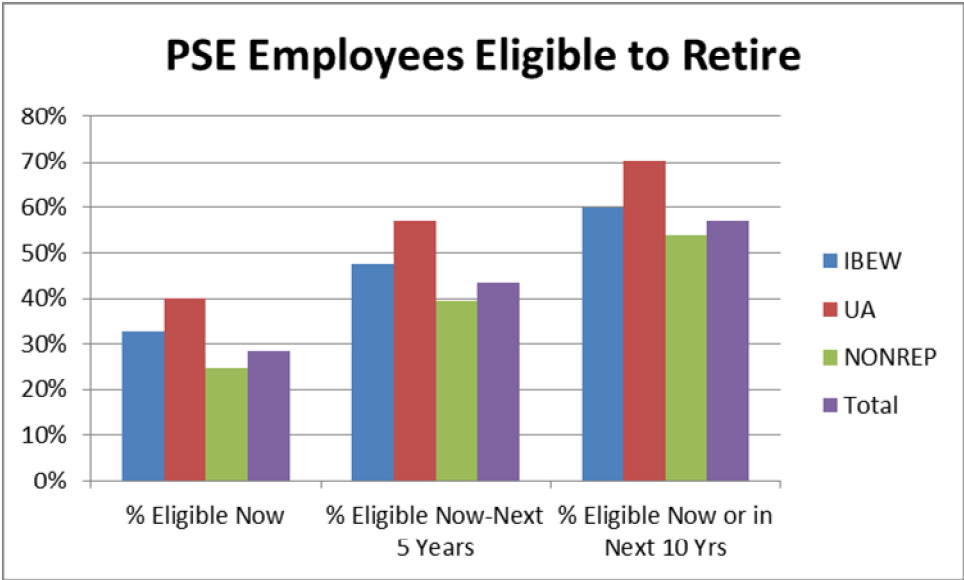
16 **Q. Does PSE face any staffing or pay-related concerns?**

17 A. Yes. PSE has two main staffing related challenges—a tighter labor market than
18 previous years and continued employee retirements. As previously discussed, a

<https://www.towerswatson.com/en-US/Insights/Newsletters/Americas/insider/2016/02/a->

1 tighter labor market creates more competition for qualified employees. Additionally,
2 PSE's employee population includes a significant proportion of employees who are
3 currently eligible or will soon be eligible to retire, which creates a significant need
4 for new qualified employees. More than 25% of PSE's employees are currently
5 eligible to retire, and more than 40% of PSE's employees will be eligible to retire
6 over the next five years. Significantly, over the course of the next decade, 60% of
7 PSE's IBEW employees and 70% of its UA employees will be eligible to retire.
8 This will result in a significant loss of skilled workers over the next decade.
9 Figure 1 below summarizes the percentages of PSE employees who are eligible or
10 will be eligible to retire within the next several years.

11 **Figure 1. PSE Employees Retirement Eligibility**



12 continuing-shift-in-retirement-offerings-in-the-fortune-500.

1 **Q. What is PSE doing to address the high number of expected retirements in the**
2 **upcoming years?**

3 A. PSE has a two-fold approach to addressing the expected high number of
4 retirements. First, PSE wants to ensure continuity of knowledge, training, and
5 leadership, and therefore has implemented talent management programs to maintain
6 a workforce willing and able to provide customers safe, dependable and efficient
7 service. Through the annual people planning process, PSE leaders consider
8 upcoming challenges including expected retirements and prioritize efforts to attract,
9 retain and develop employees. For example, PSE's Pathway to Apprenticeship, Gas
10 Worker Training, Engineer in Training, and internship programs help attract and
11 develop key entry level talent. PSE's succession planning process and leadership
12 mentoring program identify and build leaders while its training, development and
13 performance management activities help employees perform effectively in their
14 current and future roles. PSE's knowledge capture and transfer tools allow for the
15 smooth transfer of work when employees retire or otherwise leave the company.

16 The second approach to addressing employee retirements is to ensure PSE remains
17 attractive to mid-career employees and new job candidates. PSE accomplishes this
18 through the compensation philosophy and programs described earlier.

1 **D. Executive Compensation**

2 **Q. How does PSE determine the salary structure for executives?**

3 A. Officers' salaries are administered on an individual position basis and reviewed by
4 the Compensation and Leadership Development Committee of the Board. This
5 Committee is advised by an outside compensation consultant. PSE uses a market
6 comparison group of similarly-sized utility companies, and follows a pay-for-
7 performance philosophy to determine competitive salaries. PSE provided extensive
8 information about its executive compensation program in its 2015 SEC 10-K filing,
9 following the detailed Securities and Exchange Commission guidelines for
10 disclosure. Please see Exhibit No. ___(TMH-4) for an excerpt on executive pay in
11 2015 from PSE's March 2016 10-K filing.

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

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

1 **Q. What portions of executive compensation are included in the rate case?**

2 A. PSE includes in operating costs executive compensation expenses that are related to
3 utility operation and management for the main compensation programs, i.e., base
4 salary, overheads for health and welfare benefits, annual incentives from PSE's
5 Goals and Incentive Plan, and qualified retirement benefits.

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

7 A. Investors fund PSE's multi-year incentive plan, the Long Term Incentive Plan,
8 which is the single largest component of CEO compensation and is also a
9 significant part of compensation for other officers. This plan is a market-
10 competitive pay program that is fully funded by PSE's investors. In addition,
11 investors will fund all of Supplemental Executive Retirement Plan ("SERP")
12 expenses.

13 **E. Overview of How PSE Is Controlling Wage and Benefit Costs**

14 **Q. What actions has PSE taken since the last rate case to control wage and benefit**
15 **costs now and in the future?**

16 A. Since the last rate case, PSE controlled wage and benefit costs by controlling salary
17 increases and changing benefit plan designs to slow the rate of health benefits cost
18 increase and reduce future retirement plan costs. Salary increases have previously
19 been described and the benefit design changes are described in detail below.

1 **F. Employee Health Benefits**

2 **Q. Please describe PSE's employee health benefit plans.**

3 A. PSE offers a "cafeteria" benefit plan for employees. Employees have several
4 choices as to their type of medical plan, dental plan, and life insurance, etc., so that
5 they can determine the best fit for their situations. PSE allots a yearly benefit
6 amount to each employee in the form of "flexible credits," which is used monthly to
7 pay most of the cost of benefits for employee-only coverage. Employees who elect
8 more benefits than the allotment, or who elect for family coverage, contribute a
9 portion of their salary to cover the additional cost. PSE offers medical plans on a
10 self-funded or self-insured basis through health plan providers who administer the
11 terms of the plan. PSE offers dental and other benefits through insured
12 arrangements with other plan providers.

13 **Q. What actions has PSE taken since the last rate case to control increases in**
14 **medical benefits costs now and in the future?**

15 A. Employee health benefit costs at PSE, primarily medical benefits, have grown at a
16 rate similar to other organizations, and higher than consumer inflation. Since the
17 last rate case, however, PSE has taken actions to reduce its portion of these health
18 benefit costs, while also taking actions aimed at slowing the future growth of
19 medical costs. Beginning with the collective bargaining agreements in 2010 and
20 continuing with the collective bargaining agreements completed in 2013 and 2014,

1 PSE has required employees to pay a higher share of monthly medical plan costs.
2 Between 2012 and 2016, PSE's flexible credits and wellness credits, which
3 represent what PSE contributes toward benefit expense, have been flat to slightly
4 higher, with a compound annual growth rate from -0.4% to 2.6%. During this same
5 time period, other employers have seen annual cost increases between 4% to 5.5%
6 per year, as shown in Exhibit No. ____ (TMH-5C). Starting in 2013, PSE increased
7 its emphasis on employee wellness and added a wellness credit as a way to help
8 direct employees toward healthier behaviors. Over time, the wellness plan should
9 lead to a healthier employee population and lower medical claims, which will
10 benefit employees, PSE and ratepayers. Since 2012, PSE has also moved to a self-
11 insured approach.

12 **Q. Please discuss the employee insurance cost adjustments made by PSE.**

13 A. PSE adjusts employee insurance expense to the expected average cost per
14 participant for the rate year. The average cost per participant per month for the test
15 year based on average participant count was \$936.56 for IBEW employees,
16 \$1,008.06 for UA employees and \$978.27 for non-union employees. Further
17 discussion of this adjustment for both electric and natural gas can be found in the
18 prefiled direct testimony of Susan E. Free, Exhibit No. ____ (SEF-1T).

1 **Q. Why is PSE self-insured?**

2 A. PSE receives three main benefits from using a self-insurance approach to medical
3 plans. First, with the same level of claim expense over time, a self-insured plan
4 should have lower costs than an insured plan. Insured plans are required to pay a 2%
5 premium tax to the State Insurance Commissioner and self-insured plans are not.
6 Insured plans include a profit margin above their expected operating costs, while a
7 self-insured plan does not. Second, the plan design of a self-insured plan can vary
8 from State Insurance Commissioner requirements, which offers greater flexibility.
9 Finally, in a self-insured plan, PSE keeps an accounting reserve for future claims in
10 the event that the self-insured arrangement is stopped in the future, equal to an
11 estimate of any ongoing claims for services received in the current year but not yet
12 paid in the year. With an insured plan, the insurance company collects a similar type
13 of reserve as part of premium payments and keeps any amount beyond what is
14 needed.

15 **Q. How has the Affordable Care Act affected PSE?**

16 A. The Affordable Care Act has primarily affected PSE by 1) diverting internal staff
17 time to comply with the new regulations and 2) increasing vendor costs to prepare
18 for required IRS reporting that began in January 2016 and will be repeated annually.
19 While some companies have seen additional expense to increase benefit plan
20 features to match requirements of the law (such as covering all preventive services

1 at no cost or covering dependent children up to age 26), PSE’s plans were already
2 similar to the law’s requirements and just needed minor changes to comply.

3 **G. Retirement Plan**

4 **Q. What type of retirement plan does PSE offer?**

5 A. PSE offers two retirement programs for employees—a company-funded defined
6 benefit pension plan and a defined contribution 401(k) plan that receives employee-
7 and company-matching funding.

8 PSE’s “Retirement Plan for Employees of Puget Sound Energy” is a defined benefit
9 pension plan, with two distinct formulas—final average earnings and cash balance.
10 The final average earnings (FAE) formula is the traditional type of pension, which
11 provides a monthly payment upon retirement. This plan has been closed to new
12 employees since 2010 but remains in place for certain active employees represented
13 by the IBEW union. The cash balance formula is credited with annual contribution
14 amounts and interest credits, and the retiree elects whether to receive annuity
15 payments or a lump sum payment of the balance. The cash balance formula is
16 sometimes termed a “hybrid” plan because, while it is still a defined benefit plan, it
17 has features that are similar to a defined contribution plan. As shown in more detail
18 in Table 1, below, IBEW employees hired after 2010, UA employees, and non-
19 represented employees participate in the cash balance plan. PSE pension assets,
20 liabilities, and company contributions are shown on Exhibit No. ___(TMH-6C).

PSE’s “Investment Plan for Employees of Puget Sound Energy” is a defined contribution 401(k) plan. All employees participate in the same plan, but levels of PSE matching differ by employee groups and based on when the employee was hired by PSE.

Table 1, below, summarizes the retirement programs available to PSE employees.

Table 1. PSE Retirement Plans

Employee Group(s)	Pension Plan	401(k) Plan
<ul style="list-style-type: none"> IBEW Represented hired prior to 2010 and elected to remain in FAE plan 	Final Average Earnings formula	Company match of 55% of first 6% of employee pay contributed
<ul style="list-style-type: none"> UA Represented (hired before 1/1/2014) Non-represented (hired before 1/1/2014) IBEW Represented (hired before 12/11/2014, unless remaining in FAE) 	Cash balance with 3-8% annual credits based on employee age	<ul style="list-style-type: none"> Company contribution of 1% of base salary Company match of 100% of first 6% of employee pay contributed
<ul style="list-style-type: none"> Non-represented (hired 1/1/2014 or later) IBEW Represented (hired 12/11/2014 or later) 	If employee elects at hire, 4% annual company retirement contribution into cash balance	<ul style="list-style-type: none"> If cash balance not elected at hire, 4% annual company retirement contribution into 401(k) Company match of 100% of first 3% and 50% of next 3%
<ul style="list-style-type: none"> UA Represented (hired 1/1/2014 or later) 	Cash balance with 4% annual company contribution	<ul style="list-style-type: none"> Company match of 100% of first 3% and 50% of next 3%

Q. What actions has PSE taken since the last rate case to control retirement benefits costs now and in the future?

A. PSE made reductions in the levels of its contributions to retirement programs offered to new employees effective in 2014. For non-represented and UA

1 represented employees, these changes were effective 1/1/2014. For IBEW
2 represented employees, these changes were effective 12/12/2014. The level of
3 company contribution that PSE had been making annually to its cash balance
4 pension was changed from a sliding scale of 3% to 8% to a fixed 4%. The level of
5 company match that PSE had been making in the 401(k) plan was changed from
6 100% of the first 6% of pay to 100% of the first 3% of pay and 50% of the next 3%
7 of pay (an overall level of 4.5% match on 6% of pay). PSE reviewed industry
8 market data on prevalence of active pension plans (i.e., defined benefit plans) and
9 the level of total retirement contributions into pension plans and 401(k) plans. From
10 this investigation, it became clear that the market was treating new employees
11 differently than current employees. Based on this analysis, PSE determined that an
12 annual contribution of 8.5% of pay was market competitive for new employees, and
13 the existing plan remained appropriate for employees already in the plans.

14 **Q. When did PSE implement the cash balance formula in its pension plan?**

15 A. In 1998, when PSE was created from the merger of Puget Power and Light
16 Company and Washington Energy Company, PSE converted the pension formulas
17 in place and implemented a cash balance formula. At that time, the IBEW-
18 represented employees did not agree to change from the final average earnings
19 formula, and so they continued with the final average earnings formula. Since 2010,
20 all PSE employees hired participate in the cash balance formula if they choose to
21 have a pension benefit.

1 **Q. Is PSE's defined benefit pension plan market competitive in the utility**
2 **industry?**

3 A. Yes. The majority of utilities still use defined benefit pension plans in addition to
4 defined contribution plans. Many utilities that have closed their defined benefit
5 pensions to new employees still have employees hired prior to the plan close who
6 are accruing benefits. A recent Towers Watson survey demonstrates that 62% of
7 utilities had active, defined benefit plans while 31% had closed defined benefit
8 pension plans (with a closed plan meaning that new hires are not eligible but
9 existing participants continue to accrue more benefits in the plan). An additional 7%
10 of utilities had frozen plans (meaning they were not open to new employees and
11 existing participants had a frozen benefit and did not accrue more benefits in the
12 plan).² Additionally, public utilities such as Seattle City Light, Tacoma Power, and
13 Snohomish PUD have active plans and continue to provide defined benefit pension
14 plans to their new and existing employees.

² Brendan McFarland, *A Continuing Shift in Retirement Offerings in the Fortune 500*, Willis Towers Watson Insider, at 6 (Feb. 2016), available at <https://www.towerswatson.com/en-US/Insights/Newsletters/Americas/insider/2016/02/a-continuing-shift-in-retirement-offerings-in-the-fortune-500>.

1 **Q. Do many other investor-owned utilities offer a cash balance formula?**

2 A. Yes, like PSE, the majority of utilities with an active defined benefit pension plan
3 have adopted a cash balance formula.³

4 **Q. What were PSE 's contributions to the pension plan during 2016?**

5 A. PSE contributed \$24 million to the pension during 2016.

6 **Q. Are PSE's contributions expected to rise or fall during 2017 and future years?**

7 A. Pension contributions in 2017 are expected to be similar to prior years. Exhibit
8 No. ___(TMH-7C) shows future projected service costs, pension expenses and
9 pension contributions. As indicated in the chart, pension contributions have been
10 similar in recent years.

11 **Q. Please explain how the Supplemental Executive Retirement Plan relates to**
12 **PSE's pension plan and whether PSE is seeking recovery of the costs of its**
13 **Supplemental Executive Retirement Plan in this proceeding.**

14 A. Together, the qualified pension and the Supplemental Executive Retirement Plan
15 provide a pension benefit that is market competitive for executives. Without the
16 Supplemental Executive Retirement Plan, executives do not have the same
17 retirement benefit as a percentage of their salary as non-executives. These plans

1 continue to be a prevalent design element of executive retirement programs in the
2 utility industry and are necessary to offer market-competitive total compensation for
3 executives. PSE does not include Supplemental Executive Retirement Plan costs in
4 the amounts requested for recovery in this rate case, based on the order in
5 Docket UE-090704.

6 **H. Goals and Incentive Plan**

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

8 A. The Goals and Incentive Plan is a key part of PSE's compensation policy which, as
9 described earlier, includes competitive pay in the utility company market and pay
10 for performance. PSE's Goals and Incentive Plan focuses employees on achieving
11 strategic objectives that benefit customers. As part of PSE's pay-for-performance
12 philosophy, the Goals and Incentive Plan helps retain and motivate employees. The
13 program is a variable incentive plan under which employees are eligible to receive
14 incentive pay if PSE, team and individual goals are achieved, and under which
15 employees' pay is put at risk if these goals are not met. The incentive program
16 continues to emphasize performance goals that benefit customers. Please see
17 Exhibit No. ___(TMH-8) for a copy of PSE's 2016 Goals and Incentive Plan.

³ *Id.*

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

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

8 Second, the Goals and Incentive Plan slows the base wage growth that would occur
9 in a compensation system with base salaries only, which further benefits customers.

10 Under PSE's current plan, significant pay is at risk for all employees. Employees
11 must earn incentives each year, and therefore the incentives received one year do
12 not compound in future years as base salary would. Also, customers benefit by
13 having the year's total compensation dependent on PSE achieving its strategic
14 objectives.

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

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

2 A. PSE's strategic objectives are established through a long-range plan. From the long-
3 range plan, annual objectives relating to service quality and operational efficiency
4 are set by the officers each year. Team and individual goals are then formulated to
5 reflect the company-wide objectives. All employees are focused on achieving PSE's
6 annual goals as well as their individual and team goals. They are encouraged to
7 contribute ideas – such as customer service, safety and cost containment ideas – and
8 efforts to help achieve these goals.

9 **Q. Is the Goals and Incentive Plan considered part of competitive pay in the**
10 **utility company market?**

11 A. Yes. Most other companies, including investor owned utilities, follow a pay for
12 performance approach like PSE and have a portion of pay at risk in the form of
13 annual incentives. By providing the opportunity for annual incentive pay based on
14 individual performance, PSE provides market-competitive total pay.

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

17 A. Yes. Represented employees are subject to the same incentive plan terms as non-
18 represented employees, although with a lower incentive opportunity. Further, with
19 represented employees, the goals are team-based instead of individual-based.

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

2 A. All employees, including directors and officers, participate in the Goals and
3 Incentive Plan and are linked to PSE’s goals. Every non-represented employee has a
4 target incentive opportunity that is based on market competitive pay levels and
5 expressed as a percentage of his or her base salary. Officers have higher incentive
6 targets as a percentage of salary than other employees, reflecting the market levels
7 of incentive pay, and therefore have more pay at risk.

8 **Q. What are the threshold requirements for payout under the Goals and Incentive**
9 **Plan?**

10 A. For any incentive payment to be possible, two threshold requirements must be met:
11 First, PSE must meet or exceed six of its Service Quality Index (“SQI”) and Safety
12 goals. Second, PSE’s Earnings Before Interest, Taxes and Depreciation
13 (“EBITDA”) must exceed the “trigger” level. Please see Exhibit No. ___(TMH-8)
14 for additional explanation of the program.

15 **Q. Why is the level of available incentive payments based on SQI goals and**
16 **EBITDA?**

17 A. These two measures provide a clear barometer of success for employees—that
18 employees accomplish both PSE’s annual goals and continue providing good
19 customer service. If customer service quality measures are not met, then the
20 accomplishment of annual objectives is incomplete. EBITDA is related in part to

1 PSE's ability to control costs, stay within its budget, and operate efficiently. The
2 annual budget process recognizes that it costs money to develop and maintain the
3 utility's infrastructure and meet current and future customer needs. PSE completes a
4 calendar year budgeting process in which the PSE forecasts expected expenses and
5 revenues. The forecast for expenses includes expenditures on all needed activities
6 for the year that will allow for continued safe, reliable service for customers and
7 enable PSE to execute required compliance activities and plans for future customer
8 needs. The net result of forecast expenses and revenues from this comprehensive
9 budgeting process is expected earnings, which is easily tracked and understood by
10 employees. If employees and managers are not controlling expenses per the budget,
11 then expected earnings will not be achieved.

12 **Q. If the threshold requirements are met, how are team and individual awards**
13 **determined?**

14 A. The program is a pay-for-performance program, and each employee is assessed on
15 achievement and contribution towards achieving team and individual goals.
16 (Employees represented by a union have team goals only.) If threshold requirements
17 are met, an award pool is funded, but an employee must meet his or her team or
18 individual goals, before that employee receives a payout.

1 **Q. Have prior Commission orders authorized PSE to include incentive**
2 **compensation expenses in revenue requirements?**

3 A. Yes. In PSE’s 2004 general rate case, the Commission authorized PSE to recover
4 incentive compensation expenses. Recognizing that a financial measure (Earnings
5 Per Share or “EPS” at the time) was part of the program, the Commission found that
6 “while a portion of PSE’s incentive plan payments turn on PSE reaching certain
7 earnings goals, there is a second threshold for such payments that is based on
8 service quality, safety, and reliability considerations. These are the criteria we have
9 looked for in authorizing, or not, the recovery of incentive payment costs.”⁴

10 **Q. Has the Commission provided guidance on allowance of incentive**
11 **compensation since the 2004 PSE rate case order?**

12 A. Yes. In PacifiCorp’s 2005 general rate case, the Commission provided guidance
13 regarding the principles it uses when considering recovery of incentive pay:
14 “Generally, we require that an incentive payment plan provide benefits to
15 ratepayers. Under some circumstances, we have allowed in rates payments under
16 plans that have a dual benefit—to shareholders and ratepayers.”⁵ The ultimate

⁴ *WUTC v. Puget Sound Energy, Inc.*, Docket UG-040640, *et. al.*, Order 06 ¶¶ 123, 144 (Feb. 18, 2005).

⁵ *WUTC v. PacifiCorp*, Docket UE-050684, *et. al.*, Order 04 ¶ 123 (Apr. 17, 2006) (citing *WUTC v. Puget Sound Energy, Inc.*, Docket UG-040640, *et. al.*, Order 06 ¶ 144 (Feb. 18, 2005)).

1 issue, the Commission concluded, “is whether total compensation is reasonable and
2 provides benefits to ratepayers”⁶

3 **Q. Is PSE’s current Goals and Incentive Plan consistent with direction provided**
4 **by the Commission in prior cases?**

5 A. Yes. As discussed above, PSE’s total compensation plan is reasonable and provides
6 significant benefit to customers.

7 **III. CONCLUSION**

8 **Q. Does this conclude your testimony?**

9 A. Yes, it does.

⁶ *Id.* ¶ 128.