

EXH. TMH-1T
DOCKETS UE-19 ___/UG-19 ___
2019 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-19 ___
Docket UG-19 ___

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF

THOMAS M. HUNT

ON BEHALF OF PUGET SOUND ENERGY

JUNE 20, 2019

PUGET SOUND ENERGY

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

CONTENTS

I. INTRODUCTION 1

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

 A. Pay Philosophy..... 3

 B. Compensation and Benefit Trends..... 6

 C. Salary Administration 8

 D. Executive Compensation 12

 E. Overview of How PSE Is Controlling Wage and Benefit Costs..... 14

 F. Employee Health Benefits 14

 G. Retirement Plan..... 18

 H. Goals and Incentive Plan 24

III. CONCLUSION..... 30

PUGET SOUND ENERGY

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

LIST OF EXHIBITS

Exh. TMH-2	Professional Qualifications
Exh. TMH-3C	Merit Increase Trends
Exh. TMH-4	Excerpt from Executive Compensation Portion of Form 10-K
Exh. TMH-5C	Health Benefit Plans History
Exh. TMH-6	Pension Assets and Pension Benefit Obligations
Exh. TMH-7	2018 Goals and Incentives Plan

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 355 110th Avenue
8 NE, Bellevue, Washington 98004. I am the Director of Compensation and Benefits
9 for Puget Sound Energy (“PSE”).

10 **Q. Have you prepared an exhibit describing your education, relevant employment**
11 **experience, and other professional qualifications?**

12 A. Yes. Please see the First Exhibit to the Prefiled Direct Testimony of Thomas M.
13 Hunt, Exh. TMH-2, for an exhibit describing my education, relevant employment
14 experience, and other professional qualifications.

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

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

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

- Reporting on human resources information;
- Employee health and welfare benefits for all active employees (and retiree medical programs for retirees);
- Retirement plans (pension and 401(k));
- Compensation for non-bargaining unit represented employees; 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 2016, including those needed to comply with the Affordable Care Act, as amended. 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 while avoiding overpayment.

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 (for industry-specific jobs) and the broader market
9 (for cross-industry jobs); (3) to pay for performance; and (4) to offer employee
10 choice. The pay philosophy is designed to attract talented new employees and
11 motivate existing employees to stay with PSE to develop and maintain their
12 experience in operating the utility. This provides business continuity and maintains
13 a high quality of work.

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

1 benefits programs, enhances the value of PSE's pay package to employees by
2 allowing them to spend more or less for the coverages that best fit their needs, as
3 well as offering options with federal tax advantages.

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

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

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

13 A. PSE participates in third-party market surveys of pay and benefits to look at
14 company-level competitiveness (for benefits) and job specific competitiveness (for
15 annual salary and incentives). For market salary surveys, PSE purchases regional
16 and national surveys, both utility specific and cross-industry, in order to match
17 benchmark positions (which cover the majority of PSE employees) to market
18 surveys. National surveys also include break-outs of regional data, which PSE
19 reviews. PSE also receives information from surveys and third-party consultants on
20 trends in compensation and benefits. Based on the results of the market surveys and

1 identified trends, PSE considers program changes and individual market-based pay
2 adjustments.

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

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

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

17 A. PSE implements employee choice primarily in the benefits programs, where more
18 than one plan choice is offered for medical, dental and insurance coverage, with
19 different employee costs. PSE also implements employee choice through programs

1 such as workforce flexibility, where non-represented employees and supervisors
2 agree on flexible work schedule arrangements.

3 **B. Compensation and Benefit Trends**

4 **Q. What trends have you seen since 2016?**

5 A. Some of the trends in the compensation and benefit arena since 2016 are as follows:

6 1. Continued tight labor market

7 The region's employment has recovered from the recession that began in 2008, with
8 the state unemployment rate dropping from 9.9 percent in 2010 to 4.9 percent in
9 December 2016 and 4.5 percent in December 2018. In the Seattle-Bellevue-Everett
10 area, where the majority of PSE employees work, the unemployment rate has fallen
11 even lower, from 8.4 percent in 2010 to 3.6 percent in December 2016 and
12 3.4 percent in December 2018. The low unemployment rates result in more
13 competition for qualified employees.

14 2. Health care costs growing faster than consumer inflation

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

16 According to survey conducted in 2018 by Willis Towers Watson (Willis Towers
17 Watson 23rd Annual Best Practices in Health Care Employer Survey),¹ the

¹ Available at: <https://www.willistowerswatson.com/-/media/WTW/PDF/Insights/2018/12/willis-towers-watson-23rd-annual-best-practices-in-health-care-employer-survey-full-report.pdf> (last visited May 23, 2019).

1 underlying medical cost trend has been a 5-6 percent increase per year, but because
2 of employer plan changes, employer costs have experienced an average increase of
3 approximately 4-5 percent per year. Both the underlying trend and resulting
4 increase are substantially higher than consumer inflation.

5 3. Utility companies making changes to pension plans

6 While utilities are still more likely to offer defined benefit pensions than most other
7 industries, more investor owned utilities have made changes to their pension plans.
8 Willis Towers Watson reports that 16 percent of employers in all industries among
9 the Fortune 500 companies offer defined benefit pensions to new employees, as
10 compared to 48 percent of utilities and energy industry employers from this group.²
11 Many companies have changed pension benefits for new employees, either adopting
12 a cash balance formula instead of a traditional pension formula (as PSE did in 1998
13 for most employees and since 2010 for all employees), or closing the plan to new
14 employees, while existing employees continue to accrue a benefit. Regionally,
15 Seattle City Light changed the formula and terms of their traditional pension
16 effective for new hires beginning January 1, 2017, and are providing a lower benefit
17 to new employees compared to the ongoing benefit for employees hired prior to
18 2017.

² Brendan McFarland, *Retirement Offerings in the Fortune 500: A Retrospective*, WILLIS TOWERS WATSON INSIDER, at 1, 5 (Feb. 2018), available at <https://www.towerswatson.com/en/Insights/Newsletters/Americas/Insider/2018/02/evolution-of-retirement-plans-in-fortune-500-companies> (last visited May 23, 2019).

1 **C. Salary Administration**

2 **Q. How did non-union salaries change at PSE during the test year?**

3 A. On March 1, 2018, non-union employees received an average of 3.0 percent merit
4 increases.

5 **Q. How did union salaries change at PSE during the test year?**

6 A. Employees represented by the United Association of Journeymen and Apprentices
7 of the Plumbing and Pipefitting Industry of the United States and Canada (“UA”)
8 union had a wage adjustment of 3.0 percent on October 1, 2018, as stipulated in
9 their contract that was ratified on December 16, 2017. Employees represented by
10 the International Brotherhood of Electrical Workers (“IBEW”) union received a
11 wage increase of 6.0 percent on November 1, 2017, which was larger than typical
12 because it combined an increase for 2017 and 2018 as stipulated in their contract
13 that was ratified on December 12, 2017.

14 **Q. How did salaries, both union and non-union, change at PSE since the test**
15 **year?**

16 A. On March 1, 2019, non-union employees received an average of 3.5 percent merit
17 increases. PSE employees represented by the UA union are scheduled to have
18 increases of 3.0 percent on October 1, 2019, and 2.75 percent on October 1, 2020,
19 as stipulated in their contract which was ratified on December 16, 2017. Employees

1 represented by the IBEW union received a general wage increase of 3.0 percent on
2 January 1, 2019, as stipulated in their contract which was ratified on December 12,
3 2017.

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

5 A. PSE's merit increases have been similar to those in the region and the utility
6 industry. For 2016 and 2017, the utility market was projected to increase salaries by
7 approximately 3.0 percent. For 2018 actual and projected for 2019, the increases are
8 higher, with many above 3.10 percent and as high as 3.70 percent. Please see the
9 Second Exhibit to the Prefiled Direct Testimony of Thomas M. Hunt, Exh. TMH-
10 3C, for proprietary market research supporting this increase. PSE's actual non-
11 union increases of 3.0 percent in 2018 and 3.5 percent in 2019 are consistent with
12 market data. PSE's union wage increases are determined pursuant to collective
13 bargaining contracts and were similar to prior contracts.

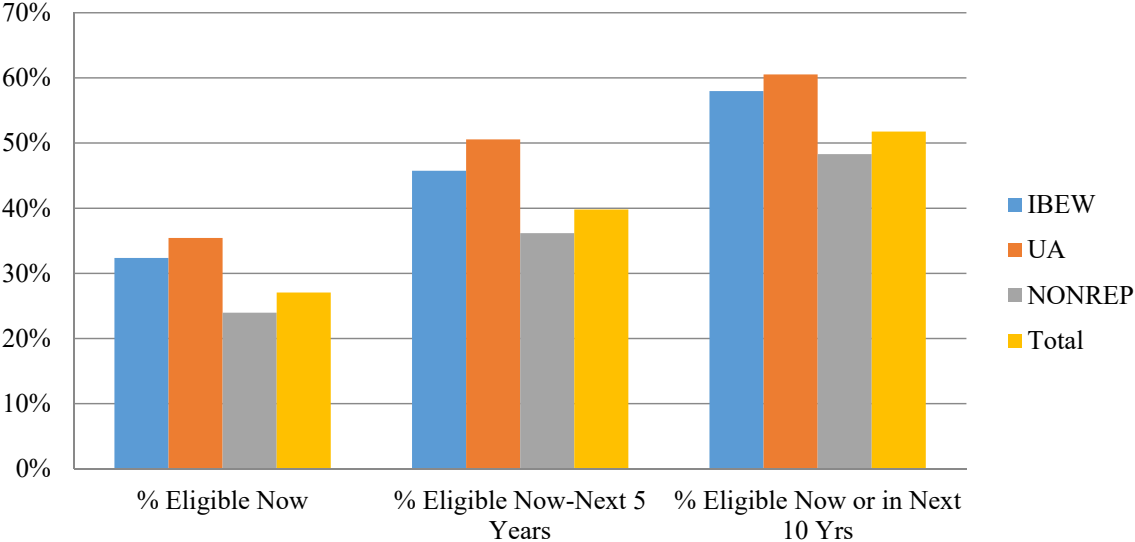
14 **Q. Does PSE face any staffing or pay-related concerns?**

15 A. Yes. PSE has two main staffing related challenges—a tighter labor market than
16 previous years and continued employee retirements. As previously discussed, a
17 tighter labor market creates more competition for qualified employees.
18 Additionally, PSE's employee population includes a significant proportion of
19 employees who are currently eligible or will soon be eligible to retire, which creates
20 a significant need for new qualified employees. More than 25 percent of PSE's

1 employees are currently eligible to retire, and 40 percent of PSE’s employees will
 2 be eligible to retire over the next five years. Significantly, over the course of the
 3 next decade, 58 percent of PSE’s IBEW employees and 61 percent of its UA
 4 employees will be eligible to retire, compared to 48 percent of non-union
 5 employees. This will result in a significant loss of skilled workers over the next
 6 decade. Figure 1 below summarizes the percentages of PSE employees who are
 7 eligible or will be eligible to retire within the next several years. While still high,
 8 the rate of employees eligible to retire within 10 years has decreased since
 9 December 2016 when the rate was 55 percent for all employees.

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

PSE Employees Eligible to Retire



11

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 SEC Form 10-K filing
9 for calendar year 2018, filed February 21, 2019, following the detailed Securities
10 and Exchange Commission guidelines for disclosure. Please see the Third Exhibit
11 to the Prefiled Direct Testimony of Thomas M. Hunt, Exh. TMH-4, for an excerpt
12 on executive pay in 2018 from PSE's February 2019 Form 10-K filing.

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

14 A. Executive leadership is a guiding force behind the utility's operations, and
15 competitive compensation is required to retain the leadership services of quality
16 executives. Customers benefit from good utility leadership that effectively and
17 efficiently manages PSE operations. PSE's executive leadership helps set effective
18 strategy, establish priorities, and manage risk for the utility; these actions result in
19 effective use of resources, reliable service for customers, and reasonable rates. Also,
20 PSE executives interact with customers and community representatives, providing

1 customers with an increased understanding of the industry and the impacts that
2 customers can have on its operations. This interaction provides a direct channel for
3 customers to hold PSE accountable on operational performance issues such as
4 reliability and cost, and environmental initiatives.

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

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

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

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

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

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

4 A. Since the last rate case, PSE has continued to control wage and benefit costs by
5 controlling salary increases and as a result of benefit plan design changes to slow
6 the rate of health benefits cost increase and reduce future retirement plan costs.
7 Salary increases have previously been described and the benefit design changes are
8 described in detail below.

9 **F. Employee Health Benefits**

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

11 A. PSE offers a "cafeteria" benefit plan for employees. Employees have several
12 choices as to their type of medical plan, dental plan, and life insurance, so that they
13 can determine the best fit for their situations. PSE allots a yearly benefit amount to
14 each employee in the form of "flexible credits," which are used monthly to pay
15 most of the cost of benefits for employee-only coverage. Employees who elect more
16 benefits than the allotment, or who elect for family coverage, contribute a portion of
17 their salary to cover the additional cost. PSE offers medical plans on a self-funded
18 or self-insured basis through health plan providers who administer the terms of the
19 plan. PSE offers dental and other benefits through insured arrangements with other
20 plan providers. Starting in 2013, PSE increased its emphasis on employee wellness

1 and added a wellness internet portal and wellness credit as a way to help direct
2 employees toward healthier behaviors. Employees covered by the medical plan who
3 reach goals for points earned through participation can receive a monthly wellness
4 credit to offset their health care costs. Over time, the wellness plan should lead to a
5 healthier employee population and lower medical claims, which will benefit
6 employees, PSE and ratepayers.

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

9 A. Employee health benefit costs at PSE, primarily medical benefits, have grown at a
10 rate similar to other organizations, and higher than consumer inflation. PSE's
11 actions taken prior to 2016 have helped control PSE's portion of these health
12 benefit costs and are expected to slow the future growth of medical costs.
13 Beginning with the collective bargaining agreements in 2010 and continuing with
14 the collective bargaining agreements completed in 2013 and 2014, PSE has required
15 employees to pay a higher share of monthly medical plan costs. Between 2014 and
16 2018, PSE's flexible credits and wellness credits, which represent what PSE
17 contributes toward benefit expense, have increased modestly, with compound
18 annual growth rates between 0.9 percent to 3.7 percent, depending on the employee
19 group, but on average less than 3 percent. During this same time period, other
20 employers have seen annual cost increases between 4 percent to 5 percent per year,
21 as previously stated in this testimony and as shown in the Fourth Exhibit to the

1 Prefiled Direct Testimony of Thomas M. Hunt, Exh. TMH-5C. Since 2012, PSE has
2 also moved to a self-insured approach, which is discussed later in this testimony.

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

4 A. PSE adjusts employee insurance expense to the expected average cost per
5 participant for the rate year. The average cost per participant per month for the test
6 year based on average participant count was \$1,040 for IBEW employees,
7 \$1,084 for UA employees and \$1,086 for non-union employees. Further discussion
8 of this adjustment for both electric and natural gas can be found in the Prefiled
9 Direct Testimony of Susan E. Free, Exh. SEF-1T.

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

11 A. PSE receives three main benefits from using a self-insurance approach to medical
12 plans. First, with the same level of claim expense over time, a self-insured plan
13 should have lower costs than an insured plan. Insured plans are required to pay a
14 2 percent premium tax to the State Insurance Commissioner and self-insured plans
15 are not. Insured plans include an insurance company profit margin above their
16 expected operating costs, while a self-insured plan does not. Second, the plan
17 design of a self-insured plan can vary from State Insurance Commissioner
18 requirements, thereby offering greater flexibility. Finally, in a self-insured plan,
19 PSE keeps an accounting reserve for future claims in the event that the self-insured
20 arrangement is stopped in the future, equal to an estimate of any ongoing claims for

1 services received in the current year but not yet paid in the year. With an insured
2 plan, the insurance company collects a similar type of reserve as part of premium
3 payments and keeps any amount beyond what is needed.

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

5 A. The Affordable Care Act has primarily affected PSE by (1) diverting internal staff
6 time to comply with the new regulations and (2) increasing vendor costs to prepare
7 for required IRS reporting that began in January 2016 and is repeated annually.
8 While some companies have seen additional expense to increase benefit plan
9 features to match requirements of the law (such as covering all preventive services
10 at no cost or covering dependent children up to age 26), PSE's plans were already
11 similar to the law's requirements and needed only minor changes to comply.

12 **Q. Has the repeal of the Affordable Care Act's individual mandate penalty**
13 **affected PSE, and if so, how?**

14 A. No, the repeal of the individual mandate for insurance, and penalty for not having
15 insurance, has not affected PSE's plans. The main impact to PSE of the Affordable
16 Care Act has been company reporting requirements and potential fines if PSE does
17 not offer coverage to 95 percent or more of eligible employees. PSE continues to
18 produce the required reporting and continues to offer coverage to more than
19 95 percent of eligible employees.

1 **G. Retirement Plan**

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

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

6 PSE’s “Retirement Plan for Employees of Puget Sound Energy” is a defined benefit
7 pension plan, with two distinct formulas—final average earnings (“FAE”) and cash
8 balance. The FAE formula is the traditional type of pension, which provides a
9 monthly payment upon retirement, but does not allow a lump sum payment of the
10 actuarial value of the plan benefit. This plan has been closed to new employees
11 since 2010 but remains in place for 166 active employees represented by the IBEW
12 union, who elected to remain on the old formula. The newer, cash balance formula
13 is credited with annual contribution amounts and interest credits, and the retiree
14 elects at retirement whether to receive annuity payments or a lump sum payment of
15 the balance. The cash balance formula is sometimes termed a “hybrid” plan
16 because, while it is still a defined benefit plan, it has features that are similar to a
17 defined contribution plan. As shown in more detail in Table 1, below, IBEW
18 employees hired after 2010, UA employees, and non-represented employees
19 participate in the cash balance plan. PSE pension assets, liabilities, and company
20 contributions are shown in the Fifth Exhibit to the Prefiled Direct Testimony of
21 Thomas M. Hunt, Exh. TMH-6.

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

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

6 **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%

7 **Q. How does PSE control retirement benefits costs now and in the future?**

8 A. PSE made reductions in the levels of its contributions to retirement programs
 9 offered to new employees effective in 2014 and these changes continue to help

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

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

19 A. In 1998, when PSE was created from the merger of Puget Power and Light
20 Company and Washington Energy Company, PSE converted the pension formulas
21 in place and implemented a cash balance formula. At that time, the IBEW-

1 represented employees did not agree to change from the final average earnings
2 formula, and so they continued with the final average earnings formula. Since 2010,
3 all PSE employees hired participate in the cash balance formula if they choose to
4 have a pension benefit.

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

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

³ 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> (last visited May 23, 2019).

1 Seattle City Light changed the terms and level of benefit of their plan for employees
2 hired on or after January 1, 2017.

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

4 A. Yes. Like PSE, the majority of utilities with an active defined benefit pension plan
5 have adopted a cash balance formula.⁴

6 **Q. What were PSE 's contributions to the pension plan during 2018?**

7 A. PSE contributed \$18 million to the pension during 2018.

8 **Q. Are PSE's contributions expected to rise or fall during 2019 and future years?**

9 A. Pension contributions in 2019 are expected to be similar to recent years.

10 **Q. What are the risks of PSE's pension being underfunded?**

11 A. In a case of extreme underfunding, PSE's pension might have difficulty paying
12 benefits to retirees; however, PSE's plan funding has never been at such extreme
13 lows. Other risks to underfunding fall in two categories: (1) additional plan
14 requirements based on funding levels compared to the plan's Funding Target
15 Attainment Percentage ("FTAP") and (2) additional costs due to the Pension
16 Benefit Guarantee Corporations ("PBGC") variable premiums required for

⁴ *Id.*

1 underfunded plans. Examples of additional plan requirements would be: required
2 quarterly plan contributions (FTAP below 100 percent), benefit restrictions (FTAP
3 below 80 percent or 60 percent), additional PBGC filings (FTAP below 80 percent),
4 and plan “at risk” designation (FTAP below 80 percent). The additional costs of
5 PBGC variable premiums are significant, since they are calculated as 3.8 percent of
6 unfunded vested liability up to a maximum of \$523 per participant in 2018. The
7 maximum for PSE’s roughly 5,500 participants would be \$2.8 million for 2018.
8 These variable rate premiums are in addition to the required flat rate premiums of
9 \$74 per participant in 2018. PBGC flat and variable premiums are used to keep the
10 PBGC solvent and do not directly benefit PSE retirement plan participants—they
11 simply increase plan expense. PBGC premiums have increased for 2019 when the
12 flat rate will be \$80 per participant and the variable rate will be 4.3 percent of
13 underfunding up to a maximum of \$541 per participant.

14 **Q. What are the risks of PSE’s pension being overfunded?**

15 A. PSE follows its contribution policy to ensure the pension is well funded but does
16 not want to contribute more than necessary to the plan because amounts contributed
17 by the Company are placed into trust and cannot be removed for other purposes. If
18 the plan becomes overfunded it would not need to make future contributions but
19 could not remove amounts already contributed.

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

4 A. Together, the qualified pension and the Supplemental Executive Retirement Plan
5 provide a pension benefit that is market competitive for executives. Without the
6 Supplemental Executive Retirement Plan, executives do not have the same
7 retirement benefit as a percentage of their salary as non-executives. These plans
8 continue to be a prevalent design element of executive retirement programs in the
9 utility industry and are necessary to offer market-competitive total compensation
10 for executives. PSE does not include Supplemental Executive Retirement Plan costs
11 in the amounts requested for recovery in this rate case, based on the order in
12 Docket UE-090704.

13 **H. Goals and Incentive Plan**

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

15 A. The Goals and Incentive Plan is a key part of PSE's compensation policy which, as
16 described earlier, includes competitive pay in the utility company and cross-
17 industry market and pay for performance. PSE's Goals and Incentive Plan focuses
18 employees on achieving strategic objectives that benefit customers. As part of
19 PSE's pay-for-performance philosophy, the Goals and Incentive Plan helps retain
20 and motivate employees. The program is a variable incentive plan under which

1 employees are eligible to receive incentive pay if PSE, team and individual goals
2 are achieved, and under which employees' pay is put at risk if these goals are not
3 met. The incentive program continues to emphasize performance goals that benefit
4 customers. Please see the Sixth Exhibit to the Prefiled Direct Testimony of
5 Thomas M. Hunt, Exh. TMH-7, for a copy of PSE's 2018 Goals and Incentive Plan.

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

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

13 Second, the Goals and Incentive Plan slows the base wage growth that would occur
14 in a compensation system with base salaries only, which further benefits customers.
15 Under PSE's current plan, significant pay is at risk for all employees. Employees
16 must earn incentives each year, and therefore the incentives received one year do
17 not compound in future years as base salary would. Also, customers benefit by
18 having the year's total compensation dependent on PSE achieving its strategic
19 objectives.

20 Third, the Goals and Incentives Plan is part of a comprehensive compensation and
21 benefits package that makes PSE an attractive employer to skilled, experienced

1 talent in the labor market. Customers directly benefit from the contributions of a
2 strong workforce that provides high-quality and efficient service.

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

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

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

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

1 **Q. Does PSE’s incentive plan apply to PSE employees who are subject to**
2 **collective bargaining agreements?**

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

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

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

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

15 A. For any incentive payment to be possible, two threshold requirements must be met:
16 First, PSE must meet or exceed six of its Service Quality Index (“SQI”) and Safety
17 goals. Second, PSE’s Earnings Before Interest, Taxes and Depreciation and
18 Amortization (“EBITDA”) must exceed the “trigger” level. Please see Exh. TMH-7
19 for additional explanation of the program.

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

3 A. These two measures provide a clear barometer of success for employees—that
4 employees accomplish both PSE’s annual goals and continue providing good
5 customer service. If customer service quality measures are not met, then the
6 accomplishment of annual objectives is incomplete. EBITDA is related in part to
7 PSE’s ability to control costs, stay within its budget, and operate efficiently. The
8 annual budget process recognizes that it costs money to develop and maintain the
9 utility’s infrastructure and meet current and future customer needs. PSE completes a
10 calendar year budgeting process in which PSE forecasts expected expenses and
11 revenues. The forecast for expenses includes expenditures on all needed activities
12 for the year that will allow for continued safe, reliable service for customers and
13 enable PSE to execute required compliance activities and plans for future customer
14 needs. The net result of forecast expenses and revenues from this comprehensive
15 budgeting process is expected earnings, which is easily tracked and understood by
16 employees. If employees and managers are not controlling expenses per the budget,
17 then expected earnings will not be achieved.

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

20 A. The program is a pay-for-performance program, and each employee is assessed on
21 achievement and contribution towards achieving team and individual goals.

1 (Employees represented by a union have team goals only.) If threshold
2 requirements are met, an award pool is funded, but an employee must meet his or
3 her team or individual goals before that employee receives a payout.

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

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

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

15 A. Yes. In PacifiCorp's 2005 general rate case, the Commission provided guidance
16 regarding the principles it uses when considering recovery of incentive pay:
17 "Generally, we require that an incentive payment plan provide benefits to
18 ratepayers. Under some circumstances, we have allowed in rates payments under

⁵ *WUTC v. Puget Sound Energy, Inc.*, Docket UG-040640 Order 06 at 55, ¶ 144 (Feb. 18, 2005).

1 plans that have a dual benefit—to shareholders and ratepayers.”⁶ The ultimate
2 issue, the Commission concluded, “is whether total compensation is reasonable and
3 provides benefits to ratepayers”⁷

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

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

8 **III. CONCLUSION**

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

10 A. Yes, it does.

⁶ *WUTC v. PacifiCorp*, Docket UE-050684, Order 04 at 48, ¶ 128 (Apr. 17, 2006) (citing *WUTC v. Puget Sound Energy, Inc.*, Docket UG-040640, Order 06 at 55, ¶ 144 (Feb. 18, 2005)).

⁷ *Id.*