WUTC DOCKET: UE-190529, et al
EXHIBIT: TMH-8T
ADMIT ☑ W/D ☐ REJECT ☐

EXH. TMH-8T
DOCKETS UE-190529/UG-190530
UE-190274/UG-190275
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-190529** **Docket UG-190530 (*Consolidated*)**
In the Matter of the Petition of **PUGET SOUND ENERGY** **For an Order Authorizing Deferral Accounting and Ratemaking Treatment for Short-life IT/Technology Investment**	**Docket UE-190274** **Docket UG-190275 (*Consolidated*)**

PREFILED REBUTTAL TESTIMONY (NONCONFIDENTIAL) OF

THOMAS M. HUNT

ON BEHALF OF PUGET SOUND ENERGY

JANUARY 15, 2020

PUGET SOUND ENERGY

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I. INTRODUCTION

Q. Are you the same Thomas M. Hunt who submitted prefiled direct testimony on June 20, 2019, on behalf of Puget Sound Energy ("PSE") in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony addresses the testimony of Mark E. Garrett, Exh. MEG-1T, witness for Public Counsel who recommends that the Commission should disallow fifty percent of the PSE Goals and Incentive Plan cost. My testimony corrects inaccurate assertions made in Mr. Garrett's testimony and describes in detail the two thresholds for funding under PSE's incentive plan and how the plan benefits ratepayers and continues the design that the Commission previously reviewed in detail and allowed in rates.

II. PSE'S GOALS AND INCENTIVE PLAN

Q. Did Public Counsel witness Mark E. Garrett correctly describe PSE's Goals and Incentive Plan?

A. No. Mr. Garrett mischaracterized PSE's plan by focusing on one of the eleven goals, the financial goal, and deemphasizing the role of the ten safety and Service

Quality Index ("SQI") goals and the inextricable connection between the one financial goal and the ten non-financial goals. The plan's funding table (Exh. TMH-07) is literally two-dimensional with many possible funding outcomes based on the combined results of safety and SQI measures vertically and the Earnings Before Interest Taxes Depreciation and Amortization ("EBITDA") financial measure horizontally. In total there are eleven goals. If less than six of the ten safety and SQI goals are met, or if EBITDA is less than ninety percent of the target, then employees receive no incentive pay under the plan.

Q. Please describe the eleven goals.

A. There are ten safety and SQI Goals and one financial goal. The safety goal has three parts measuring employee safety which all must be met for it to be accomplished, and the nine SQI goals, previously approved by the Commission, measure service quality and the results are reported publicly each year to customers. The financial goal is EBITDA, with the target level determined annually based on the target level of the Company's financial plan.

Q. Did Mr. Garrett accurately describe how the funding mechanism for PSE's Goals and Incentive Plan works?

A. No. While the witness included the full funding table that determines the plan's funding based on the combination of safety, SQI, and EBITDA, he focused on one row of the table and formed an incorrect conclusion: he stated that "as earnings increase, so does the funding level for incentives, so long as the initial earnings threshold has been met."[1]

This statement is incorrect with respect to the entire plan funding, as clearly seen on the funding table which is based on a combination of measures. For example, if safety and SQI results are 8/10, the plan can only fund a maximum of 100% of target when EBITDA is 105% of target. Once this level is reached, funding does not change even if EBITDA increase to 135% of target, in contradiction to Mr. Garrett's statement that funding continues to grow with increased earnings.

Likewise, if safety and SQI results are 7/10, the plan cannot fund more than 70% of target, even if earnings increase above the EBITDA target. If safety and SQI results are below 6/10, the plan does not fund at all, regardless of performance on the financial measure.

Q. Do the safety and SQI measures have a significant impact on the funding of the plan?

A. Yes, the safety and SQI measures are significant to the plan's operation and can have a dramatic impact on funding. First, the safety and SQI measures comprise one of the two thresholds required for funding the plan at any level and are ten of the eleven factors used to determine the level of funding. A poor performance of 5/10 on safety and SQI measures means the plan will not fund, regardless of financial performance. In most cases the plan funding is reduced by 10% for each

[1] Garrett, Exh. MEG-1T at 23:13-15.

safety or SQI measure missed; however, if more than one measure is missed, the implications for plan funding can be dramatic.

To illustrate, we can further explore the funding outcomes when safety and SQI results are 8/10. In his testimony, Mr. Garrett included a calculation of incentive funding with 10/10 safety and SQI measures and 135% of target EBITDA, which gives 200% of target funding—the maximum value on the table, and in fact, the plan's maximum funding level.[2] However, if Mr. Garrett had used 8/10 safety and SQI performance and kept financial performance the same (135% of target) the funding would instead be 100% of target—cut in half because of PSE missing two safety or SQI measures. This shows that missing just two safety and SQI targets has substantial impact on incentive funding.

Q. In Mr. Garrett's testimony he extensively referenced a survey that his firm had completed with 2018 updates.[3] Did he provide a synopsis of the survey's results for Washington?

A. No. Mr. Garrett's testimony provided synopses for twenty-three other states, but not for Washington. Mr. Garrett seems to reference his firm's 2015 survey results for Washington[4] (when he provided his understanding of how incentive plan costs are treated in Washington). Clearly missing was his firm's Washington survey results for 2018. In response to a data request from PSE, Mr. Garrett provided the current (2018) version of his firm's survey; the survey is provided as Exhibit

[2] Garrett, Exh. MEG-1T at 23:12-13.
[3] *Id.* at pp. 28-38.
[4] *Id.* at 22:1-5.

TMH-9. The synopsis for Washington is shown below and provides a different conclusion about Washington's treatment of incentive plans, one that *allows* short-term incentives, like PSE's plan.

> Washington's treatment of incentive compensation is largely based on previous cases, but remains a case-by-case basis. Generally, Short-term incentives are allowed in rates with Long-term incentives being excluded. There are no recent orders that set forth this treatment.[5]

Q. Have you reviewed the survey conducted by Mr. Garrett's firm and referenced in his testimony?

A. Yes, I have reviewed the survey, which typically lists the name and contact phone number for a staff member from the commission or regulatory body in the state, and a short summary that presumably is the staff member's view regarding the incentive regulatory treatment in that state. Sometimes a representative case or order is quoted.

Q. What bearing does the survey have on this case?

A. The first thing that I noted in reviewing the representative cases or orders that were mentioned is that I did not find any examples of other utilities with dual funding thresholds and a funding table like PSE's. Mr. Garrett's survey conclusions about plans with financial measures were based on plans that differ from PSE's plan, which is not solely funded based on financial measures. This applies to the one case Mr. Garrett cited for Washington, a 2006 Pacific Power

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[5] Hunt, Exh. TMH-9, Attach. A.

and Light case, Docket UE-061546. Pacific Power had a weighted plan, not a dual-threshold plan like PSE's, and yet in Order 08, the Commission found that while the plan included a financial metric, the scorecard related primarily to operational effectiveness, customer satisfaction, and safety, not financial performance; the plan was allowed to be recovered in rates. Therefore, Mr. Garrett's postulated "Financial Performance Rule" is misapplied when considering PSE's plan.

Instead, in my overall review of the survey, I found two consistent key themes regarding when incentives are allowed to be recovered in rates that should have bearing in this case:

1. Commissions look at the merits of incentive recovery on a case-by-case basis, including considering prior commission findings.
2. Commissions allow incentives that benefit customers to be recovered in rates.

Q. In Mr. Garrett's testimony, did he review prior Commission orders on PSE's incentive plan treatment?

A. No. My direct testimony referenced the Commission's 2004 order, which Mr. Garrett did not discuss, cite, or otherwise address.

Q. Did Mr. Garrett accurately describe the purpose of the Goals and Incentive Plan?

A. No. The purpose of the Goals and Incentive Plan is very different and more expansive than the witness's narrow definition. Mr. Garrett stated that "[i]n my opinion, utilities continue to tie incentive payments to financial performance because by doing so they achieve the primary objective of the incentive plans: to increase corporate earnings and, thereby, earnings per share (EPS)."[6] While Mr. Garrett is entitled to his opinion, it does not accurately reflect the purpose of PSE's plan, nor does it reflect the positive view of the plan by PSE employees—which provides PSE an important tool for talent retention.

Q. How is the plan understood by employees?

A. Plan participants view the plan positively because it provides an opportunity to be rewarded when PSE performs well for its customers and achieves its goals. For the largest population of non-represented employees fulfilling individual contributor roles (such as engineer, IT analyst, project manager), the target incentive of ten percent of base salary is about three times the size of an annual target merit increases of 3% to 3.5%. The plan aligns the interests of PSE employee participants and customers.

Q. Why does the incentive funding table show values considerably above target financial performance?

A. The incentive plan puts pay at risk for employees, and participants better accept pay at risk when they also feel that they have a possibility of exceeding target as well as falling short of target.

[6] Garrett, MEG-1T 42:1-4.

Q. What is the purpose of the funding scale?

A. The funding table is designed to highlight both what is needed to achieve target funding and the implications of missing or exceeding target. The focus on target is shown by the highlighting of the cells that contain "Target" and 100%. At levels of target financial performance and below, the impact of missing safety and SQI measures are the same—ten percent less for each missed, as long as at least 6/10 are met and financial performance is ninety percent or above. Above the target financial performance level, the implications of missed safety and SQI results have greater impact. The purpose of this is to clearly communicate to participants that both financial and non-financial measures must be achieved. Employees understand this and there is a significant focus on achieving safety and SQI measures.

Q. Did the Commission's order in the PSE's 2004 General Rate Case recognize that the annual incentive plan's funding included a financial measure?

A. Yes. In Order 06 in Dockets UE-040641 and UG-040640 (consolidated), the Commission recognized that PSE's incentive plan funding included a financial measure and that the plan included measures desired by the Commission:

> While PSE incentive plans have changed over time, this appears in part to be in recognition of direction from the Commission that such plans should be tied to performance and not simply to earnings. We find that while a portion of PSE's incentive plan payments turn on the Company reaching certain earnings goals, there is a second threshold for such payments that is based on service quality, safety, and reliability considerations. These are the criteria we have looked for in authorizing, or not, the recovery of incentive payment costs.

> Since they are present here, we find it is not appropriate to disallow a portion of the costs as Staff advocates.[7]

In Order 06, the Commission recognized and allowed PSE to recover the cost of the dual-threshold plan—similar to PSE's current plan—that included both safety and financial measures.

Q. How has PSE's plan changed since 2004?

A. Much is similar between PSE's current plan and the plan reviewed in the 2004 general rate case, including aspects that were mentioned in the Commission Order 06, quoted above. For example, like the 2004 plan, SQI measures are still a key part of the current plan, including functioning as a threshold for funding. Order 06, when the Commission allowed PSE's incentive plan in rates, stated:

> PSE argues that while there is an earnings goal threshold that must be met before any incentive payout, the Company's plan focuses on goals that directly benefit ratepayers such as customer service, service quality, safety, reliability, and efficient operations. According to PSE even if the earnings goal threshold is met, if the Company's service thresholds are not met, there is no payout on the earnings goal.

This feature is still in the plan as shown in the description of plan functioning above.

One notable change since 2004 was to format the plan's measures using a table and limiting plan funding in portions of the funding table where more than one safety and SQI measure had been missed. This reformatting was implemented in

[7] *WUTC v. Puget Sound Energy*, Dockets UE-040641 and UG-040640 (consolidated), Order 06 ¶ 143.

2009 and has been presented in general rate case testimony since that time. The table format and limits on plan funding increase the focus and importance on the safety and SQI measures in the plan.

Q. How does the plan benefit customers?

A. In my pre-filed testimony I outlined three ways that PSE's Goals and Incentive Plan benefits customers, which I will summarize here:

1. The plan focuses participants on key objectives of PSE, including safety, reliability, service quality, customer service and operational efficiency. The funding scale has eleven measures, as described above. In addition, non-represented employees have individual and team goals that stem from the company's Integrated Strategic Plan, and employees contribute their efforts and ideas to achieve these goals.
2. The plan slows the base wage growth that would occur in a compensation system with base salaries only, as incentives must be earned each year and future pay increases do not compound.
3. The plan is part of a comprehensive package that makes PSE attractive to skilled, experienced talent in the workplace, and customers benefit from a workforce that provides high quality and efficient service.

Q. How would you describe the EBITDA financial goal?

A. The EBITDA target is connected to the company's financial plan which is built up from departments' budgets of operations and maintenance ("O&M") expenses, planned capital expenditures, and expected revenues. It is the financial record of the expected outcome of a year's worth of effort by all employees. While it is a financial measure (in simple terms revenues minus expenses across more than a million customer accounts), accomplishing target on the financial plan requires employees to complete their work of delivering service to customers in a safe, reliable and efficient manner.

Q. Is the financial goal reasonable and of benefit to customers?

A. Yes. The financial goal is reasonable, as target performance usually represents financial performance equal to PSE's allowed rate of return. Sometimes the target is actually below the allowed rate of return, but is none-the-less what PSE management and Board of Directors think is the most likely outcome for the upcoming year.

And yes, the financial goal is of benefit to customers, because if the annual financial plan is achieved it means that results have been achieved across PSE's many departments, with all PSE employees working to provide safe, reliable and efficient service to customers. Performing at target levels of financial performance should be viewed by all parties as a desirable outcome. Additionally, it should be noted that PSE has been operating with earnings sharing bands, so that if it exceeds its authorized rate of return, fifty percent of the amount is returned to customers.

Q. How does the Goals and Incentive Plan communicate the importance of serving customers to all PSE employees?

A. The Goals and Incentive Plan communicates the importance of serving customers to PSE employees two ways. First, the SQI measures, which have been established in concert with the Commission, are understood in general terms by all employees, but are directly impacted by a number of specific employee groups who deliver service to customers. For these areas of the company, such as the customer call center, electric and gas operations during emergency response, and field services for appointments kept and customer satisfaction, the SQIs measure their direct support of customers. These employees see how their work is valued by the customers, Commission and PSE. Secondly, the plan's funding table and two funding thresholds show that SQIs and safety can have financial impacts to the level of potential incentives, with the best funding only available if all SQI and safety measures are achieved.

Q. Please summarize your recommendation to the Commission related to recovery of PSE's incentive plan.

A. PSE has carefully and thoughtfully crafted its incentive plan to be in alignment with appropriate structuring of an incentive plan as communicated by the Commission. The plan's one financial goal and ten non-financial goals are inextricably related so as to properly focus employee efforts to best benefit customers. For these reasons, the Commission should continue to allow full recovery of PSE's incentive plan in rates.

V. CONCLUSION

Q. Does this conclude your prefiled rebuttal testimony?

A. Yes, it does.