

**EXH. TMH-1T
DOCKETS UE-22____/UG-22____
2022 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-22____
Docket UG-22____**

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF

THOMAS M. HUNT

ON BEHALF OF PUGET SOUND ENERGY

JANUARY 31, 2022

PUGET SOUND ENERGY

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THOMAS M. HUNT**

I. INTRODUCTION

Q. Please state your name, business address, and position with Puget Sound Energy.

A. My name is Thomas (Tom) Hunt. My business address is 355 110th Ave. NE, Bellevue, WA 98009-9734. I am the Director of Compensation and Benefits for Puget Sound Energy (“PSE”).

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

A. Yes, I have. It is Exh. TMH-2.

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

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

- Administering the PSE's human resources system and reporting on human resources information;
 - Employee health and welfare benefits for all active employees;

- 1 • Retirement plans (pension and 401(k));
- 2 • Compensation for non-bargaining unit represented employees, as well as
- 3 support in labor negotiations for represented employees; and
- 4 • Short-term and long-term disability programs, ergonomics, job
- 5 modifications and workers compensation.

6 I also analyze executive compensation programs and provide updates to the
7 Compensation and Leadership Development Committee of the PSE Board of
8 Directors. I report directly to the Vice President of Human Resources, who has
9 overall responsibility for Human Resources.

10 **Q. Please summarize the purpose of this prefiled direct testimony.**

11 A. In my testimony, I describe the elements of PSE's pay philosophy, which includes
12 the compensation and benefits programs, and explain the steps that PSE has taken
13 to compete in a challenging labor market while controlling wage and benefit
14 costs. I also describe any significant changes in the labor market and PSE
15 program design since 2019, including related to COVID-19 and the increasing
16 prevalence of a model for work with days in-office and remote. I show that PSE's
17 programs are market competitive and provide benefits to customers by enabling
18 PSE to retain a skilled and engaged workforce while avoiding overpayment. I also
19 outline the expected costs of labor and benefits during the multi-year rate period.

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

3 **A. Pay Philosophy**

4 **Q. Please describe PSE's pay philosophy.**

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

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

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

3 **Q. How does PSE make its pay and benefits market competitive?**

4 A. PSE participates in third-party market surveys of pay and benefits to look at
5 company-level competitiveness (for benefits) and job specific competitiveness
6 (for annual salary and incentives). For market salary surveys, PSE purchases
7 regional and national surveys, both utility specific and cross-industry, in order to
8 match benchmark positions (covering the majority of PSE employees) to market
9 surveys. National surveys also include breakouts of regional data for jobs with
10 significant populations of incumbents and, when present, PSE reviews these. PSE
11 also receives information from surveys and third-party consultants on trends in
12 compensation and benefits. Based on the results of the market surveys and
13 identified trends, PSE considers program changes and individual market-based
14 pay adjustments.

15 **Q. What are the elements of PSE's pay-for-performance philosophy?**

16 A. PSE implements pay-for-performance through merit increases (for non-
17 represented employees) and through its Goals and Incentive Plan, which is
18 described in a later section of my testimony. PSE's salary grade structure allows
19 managers to set base salaries of non-union employees within the full range of
20 labor-market rates, as identified in third-party market surveys. An employee's
21 position within the pay range ("Position in Range") depends upon several factors

1 including experience, skill, knowledge and performance. Performance is
2 evaluated annually for non-union employees, assessing individual performance on
3 goals and PSE's expected competencies. PSE managers and supervisors reinforce
4 pay-for-performance by rating an employee's performance and using this rating
5 and the employee's Position in Range to determine merit salary increases, with
6 guidelines for higher increases for better performance ratings.

7 **Q. What are the elements of PSE's employee choice philosophy?**

- 8 A. PSE implements employee choice primarily in the benefits programs, where
9 multiple plan choices are offered for medical, dental and insurance coverage, with
10 different employee costs. In addition, employees with spouses/domestic partners
11 or children can determine whether to elect family coverage, or if the spouse
12 covers family members, elect employee only coverage. PSE also implements
13 employee choice through programs such as workforce flexibility, where non-
14 represented employees and supervisors agree on flexible work schedule
15 arrangements or "hybrid" work schedules that combine remote working and in-
16 office working.

17 **B. Compensation and Benefit Trends**

18 **Q. What trends have you seen since 2019?**

- 19 A. Some of the trends in the compensation and benefit arena since 2019 are as
20 follows:

1 1. Continued tight labor market

2 The region's employment has recovered from the recession that began in 2008
3 and the more recent economic shock associated with the COVID-19 pandemic as
4 shown in the chart below from the Monthly Employment Report, Washington
5 State October 2021.¹ Washington State's unemployment rate was 3.9% in
6 December 2019, 5.3% in March 2020, climbed to 16.3% in April 2020, before
7 falling to 6.3% in December 2020 and 5.0% in October 2021. In the Seattle-
8 Bellevue-Everett area, where the majority of PSE employees work, the
9 unemployment rates have followed a similar trajectory, although the rates started
10 lower and look to return to levels lower than the State levels, with unemployment
11 at 2.4% in December 2019, 5.1% in March 2020, 16.6% in April 2020, 5.8% in
12 December 2020, and 4.9% in October 2021.



13 The low unemployment rates result in more competition for qualified employees.

14
¹ Employment Security Department, *Monthly Employment Report* (Oct. 2021)
<https://esd.wa.gov/labormarketinfo/monthly-employment-report>.

1 2. Competition from technology companies

2 Separate from the low unemployment rate, competition from technology
3 companies continues to grow in the King County region, as these companies add
4 jobs with high rates of pay. According to the Washington Technology Industry
5 Association (“WTIA”), the technology sector in the state grew by 84% between
6 2010 and 2019, adding 120,100 jobs. The 2021 WTIA report on the Washington
7 technology sector is attached as Exh. TMH-3. During the COVID-19 pandemic
8 period, the region’s technology sector continued to grow (+20,300 new workers in
9 2020) while employment in the state fell by 180,800 jobs.² These jobs had an
10 average wage before benefits of \$210,300 in 2020, compared to the state average
11 of \$75,900.³ The growth of the technology sector in our area is expected to
12 continue, with Amazon planning to add 25,000 new jobs in Bellevue, and Google
13 and Meta (formerly Facebook) developing additional campuses in Kirkland and
14 Bellevue.⁴ Companies in the technology sector present several challenges for PSE
15 as they shape the competitiveness of market pay in the region. First, these
16 companies with large hiring plans are a direct retention risk for PSE’s non-utility
17 specific jobs, in the Information Technology area and corporate support functions.
18 Second, these companies operate globally and their employment brands and
19 career development opportunities in Information Technology areas are difficult
20 for a regional company like PSE to match. And finally, these companies are less

² Exh. TMH-3 at 8.

³ *Id.*

⁴ *Id.* at 24.

1 sensitive to labor costs because of their large profit margins and create wage
2 pressure for all jobs in the area, in general, but even more acutely in situations of
3 market shortages for roles, such as cyber security.

4 A more recent source of labor competition comes from companies that allow
5 remote work from anywhere, discussed further later in my testimony.

6 3. Union contract changes

7 Some positions represented by the IBEW have experienced significant market
8 adjustments. PSE reviews non-represented positions and market surveys on an
9 annual basis, while represented positions are usually reviewed prior to contract
10 renewal periods of the Collective Bargaining Agreements, usually every three to
11 four years. However, after PSE and the IBEW signed a new contract in March
12 2020, there have been significant adjustments by regional public utilities—
13 Snohomish PUD, Seattle City Light, and Tacoma Power—with qualified
14 electrical workers receiving adjustments to base salary as high as 17%.

15 Exh. TMH-4 summarizes wage changes by those regional public utilities. PSE has
16 monitored and analyzed these market increases, and effective December 1, 2021,
17 adjusted the pay rates of about half of the IBEW A Group job classifications. The
18 adjustments ranged from 1.3% to 16%, with many between 1.3% and 7.2%.

19 4. Health care costs growing faster than consumer inflation

1 Health care expenses have grown faster than consumer inflation in most years and
2 are expected to do so in the future. According to a survey conducted in 2021 by
3 Willis Towers Watson, except for 2020 when the pandemic interrupted normal
4 medical care, the underlying medical cost trend has been a 5-6% increase per
5 year, but because of employer plan changes, employer costs have experienced an
6 average increase per employee of approximately 4-5% per year.⁵ Both the
7 underlying trend and resulting increase per employee have been substantially
8 higher than consumer inflation.

9 5. Utility companies making changes to pension plans

10 While utilities are still more likely to offer defined benefit pensions than most
11 other industries, more investor-owned utilities have made changes to their pension
12 plans. Willis Towers Watson reports that 14% of employers in all industries
13 among the Fortune 500 companies offer defined benefit pensions to new
14 employees, as compared to 46% of utilities and energy industry employers from
15 this group.⁶ Many companies have changed pension benefits for new employees,
16 either adopting a cash balance formula instead of a traditional pension formula (as
17 PSE did in 1998 for most employees and since 2010 for all employees), or closing
18 the plan to new employees, while existing employees continue to accrue a benefit.

⁵ Willis Towers Watson, *With healthcare cost increases returning to pre-pandemic levels, U.S. employers focus on affordability and wellbeing* (Oct. 6, 2021). <https://www.willistowerswatson.com/en-US/News/2021/10/with-healthcare-cost-increases-returning-to-pre-pandemic-levels-us-employers-focus-on-affordability> (last accessed Dec. 30, 2021).

⁶ Brendan McFarland, *Retirement Offerings in the Fortune 500: A Retrospective*, WILLIS TOWERS WATSON INSIDER, at 1, 5 (Feb. 2018), <https://www.willistowerswatson.com/en-US/Insights/2020/06/retirement-offerings-in-the-fortune-500-1998-2019>.

1 Regionally, Seattle City Light changed the formula and terms of their traditional
2 pension effective for new hires beginning January 1, 2017, and are providing a
3 lower benefit to new employees compared to the ongoing benefit for employees
4 hired prior to 2017.

5 **Q. Did the COVID-19 pandemic create changes to PSE's labor market,
6 compensation philosophies, or benefits provided?**

- 7 A. For PSE, as with most employers, the COVID-19 pandemic has impacted the
8 workplace and required new policies to promote employee, customer, and
9 community safety, but these have not led to changes in PSE's compensation
10 philosophies or represented significant changes in the labor market, because all
11 organizations were faced with the same conditions. On a temporary basis during
12 the pandemic, PSE required employees who could work remotely from home to
13 do so, and many employees continue to do so, with an expected reopening of most
14 office locations in the first quarter of 2022. PSE has also created temporary
15 COVID-19 time-off policies to allow employees to receive pay for time not
16 worked due to temporary office closures for disinfection after COVID-19
17 exposure, needing to quarantine after an exposure to COVID-19, or illness from
18 COVID-19. As part of encouraging employees to become vaccinated, time off is
19 provided for receiving each vaccine dose and in case of side effects. For a period
20 of time when orders by the Washington governor limited customer contact to
21 certain essential job functions, PSE continued pay for those employees who were
22 not permitted to work and whose work did not allow them to work from home.

1 In addition to workplace policies and interim paid time off provisions, PSE
2 implemented features of the federal Coronavirus Aid, Relief, and Economic
3 Security (“CARES”) Act which allowed plan participants greater access to their
4 401(k) balances if they, or their family, had been financially impacted by the
5 COVID-19 pandemic. The CARES Act features implemented are described below
6 in the section about retirement benefits.

7 **Q. Does PSE expect ongoing changes to the labor market, compensation**
8 **philosophies, or benefits provided based on the experiences of remote work**
9 **during the COVID-19 pandemic?**

10 A. Yes. Trends towards flexible work arrangements, which had begun prior to the
11 COVID-19 pandemic, have greatly increased and will remain as features of the
12 competitive labor market. For example, PSE’s labor market competitors have
13 multiplied because of jobs that can be performed remotely. Companies outside of
14 the region could previously attract PSE employees, but switching to an out of
15 region employer meant relocating. That is no longer the case; competitors can
16 attract PSE employees without requiring relocation. While PSE does not
17 anticipate that this trend will put very many PSE jobs at risk, it adds to the other
18 challenges with our region’s competitive labor market.

19 After seeing the success of required work from home by many office-based
20 employees, PSE is implementing a “hybrid” working model for many positions,
21 where workgroups are able to determine how many days per week an employee

1 will work in the office or remote (with “remote” meaning either at home or in a
2 PSE location different than their main office.) This new approach expands on the
3 “employee choice” element of PSE’s compensation philosophy.

4 **C. Salary Administration**

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

6 A. On March 1, 2021, non-union employees received an average of 3.56% merit
7 increases. Employees represented by the United Association of Journeymen and
8 Apprentices of the Plumbing and Pipefitting Industry of the United States and
9 Canada (“UA”) union had wage adjustment of 2.75% on October 1, 2020, as
10 stipulated in their contract that was ratified on December 16, 2017. Employees
11 represented by the International Brotherhood of Electrical Workers (“IBEW”)
12 union received a 3.0% general wage increase effective January 1, 2021, as
13 stipulated in their contract that was ratified on April 1, 2020.

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

16 A. As mentioned above, on March 1, 2021, non-union employees received an
17 average of 3.56% merit increases. PSE employees represented by the UA union
18 ratified a new contract December 20, 2021 and received a general wage increase
19 of 9.0%, effective October 1, 2021, and will have an increase of 3.5% on
20 October 1, 2022, as stipulated in the new contract. Please see the Prefiled Direct

1 Testimony of Susan E. Free, Exh. SEF-1T for the way in which these wage
2 increases are incorporated into the revenue request in this filing. As mentioned
3 earlier in my testimony, certain qualified electric craft positions in the IBEW
4 union received adjustments effective December 1, 2021.

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

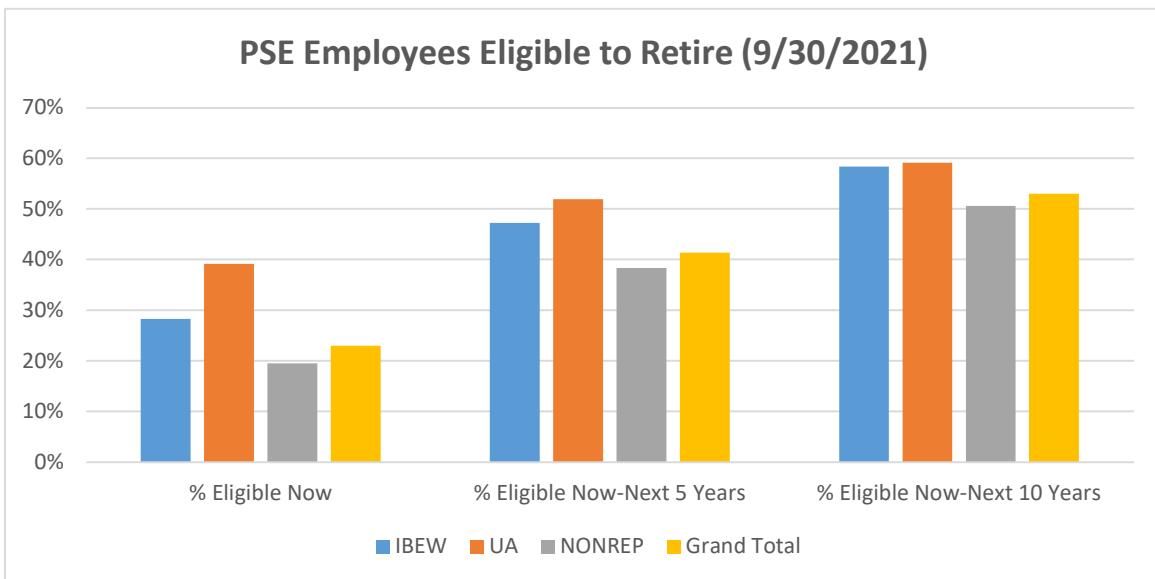
6 A. PSE's merit increases have been similar to those in the region and the utility
7 industry. For 2019 and 2020, the utility market was projected to increase salaries
8 by approximately 3.0%. For 2020 actual and projected for 2021, the increases are
9 higher, with many above 3.1% and as high as 3.5%. Exh. TMH-5C contains
10 proprietary market research supporting this increase. PSE's actual standard non-
11 union merit increases of 3.5% in 2020 and 3.5% in 2021 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 for the IBEW. The UA
14 contract ratified December 20, 2021 included an initial wage increase larger than
15 prior contracts, in part because of reductions in job family progressions. PSE's
16 initial contract proposal to employees represented by the UA was rejected by
17 members on October 25, 2021. As mentioned earlier, certain qualified electric
18 craft positions in the IBEW union were prompted by unusual and significant pay
19 changes at regional public utilities and were adjusted effective December 1, 2021.

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

2 A. Yes. PSE has two main staffing related challenges: a continued tighter labor
3 market than previous years and continued employee retirements. As previously
4 discussed, a tighter labor market creates more competition for qualified
5 employees. Additionally, PSE's employee population includes a significant
6 proportion of employees who are currently eligible or will soon be eligible to
7 retire, which creates a significant need for new qualified employees. More than
8 20% of PSE's employees are currently eligible to retire, and 41% of PSE's
9 employees will be eligible to retire over the next five years. Significantly, over the
10 course of the next decade, 58% of PSE's IBEW employees and 59% of its UA
11 employees will be eligible to retire, compared to 51% of non-union employees.
12 This will result in a significant loss of skilled workers over the next decade.

Figure 1 below summarizes the percentages of PSE employees who are eligible or will be eligible to retire within the next several years. While still high, the rate of employees eligible to retire now has decreased since December 2018 when the rate was 27%, while the rate of employees eligible to retire within 10 years is the same as December 2018 at 52%, but has decreased since December 2016 when the rate was 55% for all employees.

Figure 1. PSE Employees Retirement Eligibility



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

- A. PSE has a two-fold approach to addressing the expected high number of retirements. First, PSE wants to provide for continuity of knowledge, training, and leadership, and therefore has implemented talent management programs to maintain a workforce willing and able to provide customers safe, reliable, and efficient service. Through the annual personnel planning process, PSE leaders consider upcoming challenges including expected retirements and prioritize efforts to attract, retain and develop employees. For example, PSE's Pathway to Apprenticeship, Gas Worker Training, Engineer in Training, and internship programs help attract and develop key entry level talent. PSE's succession planning process and leadership mentoring program identify and build leaders while its training, development, and performance management activities help

1 employees perform effectively in their current and future roles. PSE's knowledge
2 capture and transfer tools allow for the smooth transfer of work when employees
3 retire or otherwise leave the company.

4 The second approach to addressing employee retirements is for PSE to remain
5 attractive to mid-career employees and new job candidates. PSE accomplishes
6 this through the compensation philosophy and programs described earlier.

7 **D. Executive Compensation**

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

9 A. Officers' salaries are administered on an individual position basis and reviewed
10 by the Compensation and Leadership Development Committee of the Board. This
11 Committee is advised by an outside compensation consultant. PSE uses a market
12 comparison group of similarly-sized utility companies and follows a pay-for-
13 performance philosophy to determine competitive salaries. PSE provided
14 extensive information about its executive compensation program in its SEC 10-K
15 filing for calendar year 2020, filed February 26, 2021, following the detailed
16 Securities and Exchange Commission guidelines for disclosure. Please see
17 Exh. TMH-6 for an excerpt on executive pay in 2020 from PSE's February 2021
18 10-K filing.

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

3 A. Executive leadership is a guiding force behind the utility's operations, and
4 competitive compensation is required to retain the leadership services of quality
5 executives. Customers benefit from good utility leadership that effectively and
6 efficiently manages PSE operations. PSE's executive leadership helps set
7 effective strategy, establish priorities, and manage risk for the utility; these
8 actions result in effective use of resources, reliable service for customers, and
9 reasonable rates. Also, PSE executives interact with customers and community
10 representatives, providing customers with an increased understanding of the
11 industry and the impacts that customers can have on its operations. This
12 interaction provides a direct channel for customers to hold PSE accountable on
13 operational performance issues such as reliability and cost, and environmental
14 initiatives.

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

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

- 1 Q. **What components of executive compensation are paid by the investors?**
- 2 A. Investors fund PSE's multi-year incentive plan, the Long-Term Incentive Plan,
- 3 which is the single largest component of CEO compensation and is also a
- 4 significant part of compensation for other officers. This plan is a market-
- 5 competitive pay program that is fully funded by PSE's investors. In addition,
- 6 investors fund all of Supplemental Executive Retirement Plan ("SERP")
- 7 expenses. The SERP plan was closed to new participants in 2019 and an Officer
- 8 Restoration Plan has been added, which provides company retirement
- 9 contributions that would have been received in the pension or 401(k) plan if not
- 10 limited by IRS contribution maximums.

11 **E. Overview of How PSE is Controlling Wage and Benefit Costs**

- 12 Q. **What actions has PSE taken since the last rate case to control wage and**
- 13 **benefit costs now and in the future?**
- 14 A. Since the last rate case, PSE has continued to control wage and benefit costs by
- 15 controlling salary increases and, as a result of benefit plan design changes,
- 16 slowing the rate of health benefits cost increase, and reducing future retirement
- 17 plan costs. Salary increases have previously been described and the benefit design
- 18 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, 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 are used
7 monthly to pay most of the cost of benefits for employee-only coverage.
8 Employees who elect more benefits than the allotment, or who elect for family
9 coverage, contribute a portion of their salary to cover the additional cost. PSE
10 offers medical plans on a self-funded or self-insured basis through health plan
11 providers who administer the terms of the plan. PSE offers dental and other
12 benefits through insured arrangements with other plan providers. Since 2013, PSE
13 has increased its emphasis on employee wellness and added a wellness internet
14 portal and wellness credit as a way to help direct employees toward healthier
15 behaviors and provide resources to address physical and mental health needs.
16 Employees and spouses covered by the medical plan who reach goals for points
17 earned through participation can receive a monthly wellness credit to offset their
18 health care costs. Over time, the wellness plan should lead to a healthier employee
19 population and lower medical claims, which will benefit employees, PSE, and
20 ratepayers.

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

3 A. Employee health benefit costs at PSE, primarily medical benefits, have grown at a
4 rate similar to other organizations, and higher-than-consumer inflation. PSE's
5 actions taken prior to 2019 have helped control PSE's portion of these health
6 benefit costs and are expected to slow the future growth of medical costs.
7 Beginning with the collective bargaining agreements in 2010 and continuing with
8 the collective bargaining agreements completed in 2017 and 2021, PSE has
9 required employees to pay a share of monthly medical plan costs. Between 2015
10 and 2020, PSE's flexible credits and wellness credits, which represent what PSE
11 contributes toward benefit expense, increased modestly, with compound annual
12 growth rates between 2.27% to 3.39%, depending on the employee group, but on
13 average less than 3%. More recently, calculated from 2017 to 2022, the range of
14 annual growth rates have been lower, between 1.38% to 2.38% or about 2% on
15 average. During these same time periods, other employers have seen annual cost
16 increases between 4% to 5% per year, as shown in Exh. TMH-7C. Since 2012,
17 PSE has employed a self-insured approach, which is discussed later in my
18 testimony.

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

20 A. PSE adjusts employee insurance expense to the expected average cost per
21 participant for the rate year. The average cost per participant per month for the

1 test year based on average participant count was \$1,120 for IBEW employees,
2 \$1,130 for UA employees and \$1,108 for non-union employees. End of period
3 amounts as of June 2021 and September 2021 were \$1,127 and \$1,131 for IBEW,
4 \$1,137 and \$1,163 for UA, and \$1,103 and \$1,105 for non-union employees.
5 Further discussion of this adjustment for both electric and natural gas can be
6 found in the Prefiled Direct Testimony of Susan E. Free, Exh. SEF-1T.

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

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

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
5 employee- and company-matching funding.

6 PSE’s “Retirement Plan for Employees of Puget Sound Energy” is a defined
7 benefit pension plan, with two distinct formulas—final average earnings (“FAE”)
8 and cash balance. The FAE formula is the traditional type of pension, which
9 provides a monthly payment upon retirement, but does not allow a lump sum
10 payment of the actuarial value of the plan benefit. This plan has been closed to
11 new employees since 2010 but remains in place for 135 active employees
12 represented by the IBEW union, who elected to remain on the old formula. The
13 newer, cash balance formula is credited with annual contribution amounts and
14 interest credits, and the retiree elects at retirement 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,
17 it has features that are similar to a defined contribution plan. As shown in more
18 detail in Table 1, below, IBEW employees hired after 2010, UA employees, and
19 non-represented employees participate in the cash balance plan. PSE pension
20 assets, liabilities, and company contributions are shown on Exh. TMH-8C.

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 salaryCompany 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
4 company contribution that PSE had been making annually to its cash balance
5 pension was changed from a sliding scale of 3% to 8% to a fixed 4%. The level of
6 company match that PSE had been making in the 401(k) plan was changed from
7 100% of the first 6% of pay to 100% of the first 3% of pay and 50% of the next
8 3% of pay (an overall level of 4.5% match on 6% of pay). PSE reviewed industry
9 market data on prevalence of active pension plans (i.e., defined benefit plans) and
10 the level of total retirement contributions into pension plans and 401(k) plans.
11 From this investigation, it became clear that the market was treating new
12 employees differently than current employees. Based on this analysis, PSE
13 determined that an annual maximum retirement contribution of 8.5% of pay was
14 market competitive for new employees, and the existing plan remained
15 appropriate for employees already in the plans, since peer organizations have also
16 kept a two-tier design. PSE monitors market information and the level of
17 company retirement benefit for new employees continues to be competitive. No
18 program changes have been made since the last rate case.

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

- 20 A. In 1998, when PSE was created from the merger of Puget Power and Light
21 Company and Washington Energy Company, PSE converted the pension formulas
22 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 until 2010.
3 Since 2010, all PSE employees hired participate in the cash balance formula if
4 they choose to 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 2020 Willis Towers Watson survey demonstrates that
11 50% of utilities had active, defined benefit plans while 46% had closed defined
12 benefit pension plans (with a closed plan meaning that new hires are not eligible
13 but existing participants continue to accrue more benefits in the plan).⁷ Only 4%
14 of utilities had frozen plans (meaning they were not open to new employees and
15 existing participants had a frozen benefit and did not accrue more benefits in the
16 plan).⁸ Additionally, public utilities such as Seattle City Light, Tacoma Power,
17 and Snohomish PUD have active plans and continue to provide defined benefit
18 pension plans to their new and existing employees. As noted earlier, Seattle City

⁷ Brendan McFarland, *Retirement Offerings in the Fortune 500*, WILLIS TOWERS WATSON INSIDER, at 6 (June 25, 2020), <https://www.willistowerswatson.com/en-US/Insights/2020/06/retirement-offerings-in-the-fortune-500-1998-2019>.

⁸ *Id.*

1 Light changed the terms and level of benefit of their plan for employees hired on
2 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.⁹

6 **Q. What were PSE's contributions to the pension plan during 2020?**

- 7 A. PSE contributed \$18 million to the pension during 2020.

8 **Q. Are PSE's contributions expected to rise or fall during 2021 and future
9 years?**

- 10 A. Pension contributions in 2021 and future years are expected to be similar to recent
11 years.

12 **Q. How does PSE determine the amount of its pension funding?**

- 13 A. PSE has a pension funding guideline document that establishes a range of funding
14 each year in order to provide for long term funding of the plan. The guidelines are
15 based on actuarial calculations completed by PSE's pension actuarial firm,
16 Milliman, Inc. and require at the low end of the range that PSE contribute at least
17 the minimum required funding per IRS regulations. At the high end of the range,
18 PSE could contribute up to the level of maximum IRS deductible contribution;

⁹ *Id.*

however, this high end is usually extremely high. For example, the 2020 range of contributions per the funding guidelines were \$0 (minimum required funding) to \$314.6 million (maximum IRS deductible contribution.) PSE selects a value within the range of funding guidelines, shown on Exh. TMH-9, which for 2020 was a range of \$0 to \$47 million as shown on the attached pension funding example for 2020, Exh. TMH-10.

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

A. Pension plan funding levels can be volatile, as seen in Exh. TMH-8C, where the pension obligation can rise or fall significantly, and as well the market value of assets can fall dramatically in a market drop. At the extreme, if PSE's pension was dramatically underfunded, the plan would have difficulty paying benefits to retirees. Fortunately, PSE's plan funding has never been at such extreme lows.

Other risks to underfunding fall in two categories: (1) additional plan requirements based on funding levels compared to the plan's Funding Target Attainment Percentage ("FTAP") and (2) additional costs due to the Pension Benefit Guarantee Corporations ("PBGC") variable premiums required for underfunded plans. Examples of additional plan requirements would be: required quarterly plan contributions (FTAP below 100%), benefit restrictions (FTAP below 80% or 60%), additional PBGC filings (FTAP below 80%), and plan "at risk" designation (FTAP below 80%). The additional costs of PBGC variable premiums are significant, since they are calculated as 4.6% of unfunded vested liability up to a maximum of \$582 per participant in 2021. The maximum for

PSE's roughly 5,500 participants would be \$3.2 million for 2021. These variable rate premiums are in addition to the required flat rate premiums of \$86 per participant in 2021. PBGC flat and variable premiums are used to keep the PBGC solvent and do not directly benefit PSE retirement plan participants—they simply increase plan expense. PBGC premiums are increased for 2022 when the flat rate will be \$88 per participant and the variable rate will be 4.8% of underfunding up to a maximum of \$598 per participant.

Q. What are the risks of PSE's pension being overfunded?

A. PSE follows its contribution policy to maintain a pension that is well funded but does not want to contribute more than necessary to the plan because amounts contributed by PSE are placed into trust and cannot be removed for other purposes. If the plan becomes overfunded, PSE would not need to make future contributions but also could not remove amounts contributed.

Q. Please explain how the Supplemental Executive Retirement Plan and Officer Restoration Plan relate to PSE's pension plan and whether PSE is seeking recovery of the costs of its Supplemental Executive Retirement Plan in this proceeding.

A. Together, the qualified pension and the Officer Restoration Plan (or the closed Supplemental Executive Retirement Plan for officers who joined or were promoted prior to 2019) provide a pension benefit that is market competitive for executives. Without the Officer Restoration Plan or Supplemental Executive

1 Retirement Plan, executives would not have the same retirement benefit as a
2 percentage of their salary as non-executives. These plans continue to be a
3 prevalent design element of executive retirement programs in the utility industry
4 and are necessary to offer market-competitive total compensation for executives.
5 PSE does not include the Officer Restoration Plan or the Supplemental Executive
6 Retirement Plan costs in the amounts requested for recovery in this rate case,
7 based on the order in Docket UE-090704 related to the SERP.

8 **H. Goals and Incentive Plan**

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

10 A. The Goals and Incentive Plan is a key part of PSE's compensation policy which,
11 as described earlier, includes competitive pay in the utility company and cross-
12 industry market and pay for performance. PSE's Goals and Incentive Plan focuses
13 employees on achieving strategic objectives that benefit customers. As part of
14 PSE's pay-for-performance philosophy, the Goals and Incentive Plan helps retain
15 and motivate employees. The program is a variable incentive plan under which
16 employees are eligible to receive incentive pay if PSE, team and individual goals
17 are achieved, and under which employees' pay is put at risk if these goals are not
18 met. The incentive program continues to emphasize performance goals that
19 benefit customers. Please see Exh. TMH-11 for a copy of PSE's 2020 Goals and
20 Incentive Plan.

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.

3 First, 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
9 occur in a compensation system with base salaries only, which further benefits
10 customers. Under PSE's current plan, significant pay is at risk for all employees.
11 Employees must earn incentives each year, and therefore the incentives received
12 one year do not compound in future years as base salary would. Also, customers
13 benefit by having the year's total compensation dependent on PSE achieving its
14 strategic 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 and
17 experienced talent in the labor market. Customers directly benefit from the
18 contributions of a strong workforce that provides high-quality and efficient
19 service.

1 **Q. How has the PSE Goals and Incentive Plan changed since 2019?**

2 A. The basic plan design of the Goals and Incentive Plan has not changed since
3 2019.

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

5 A. PSE's strategic objectives are established through a long-range plan. From the
6 long-range plan, annual objectives relating to service quality and operational
7 efficiency are set by the officers each year. Team and individual goals are then
8 formulated to reflect the company-wide objectives. All employees are focused on
9 achieving PSE's annual goals as well as their individual and team goals. They are
10 encouraged to contribute ideas—such as customer service, safety, and cost
11 containment ideas—and efforts to help achieve 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 that includes a portion of pay at risk in the form
16 of annual incentives. By providing the opportunity for annual incentive pay based
17 on individual performance, PSE provides market-competitive total pay.

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

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

Q. How is PSE's incentive plan structured at the corporate executive level?

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

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

A. For any incentive payment to be possible, two threshold requirements must be met: First, PSE must meet or exceed six of its Service Quality Index (“SQI”) and Safety goals. Second, PSE’s Earnings Before Interest, Taxes and Depreciation and Amortization (“EBITDA”) must exceed the “threshold” level. Please see Exh. TMH-11 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
10 completes a calendar year budgeting process in which it forecasts expected
11 expenses and revenues. The forecast for expenses includes expenditures on all
12 needed activities for the year that will allow for continued safe, reliable service
13 for customers and enable PSE to execute required compliance activities and plans
14 for future customer needs. The net result of forecast expenses and revenues from
15 this comprehensive budgeting process is expected earnings, which is easily
16 tracked and understood by employees. If employees and managers are not
17 controlling expenses per the budget, 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
10 certain earnings goals, there is a second threshold for such payments that is based
11 on service quality, safety, and reliability considerations. These are the criteria PSE
12 has looked for in authorizing, or not, the recovery of incentive payment costs.”¹⁰
13 The Commission again allowed PSE’s adjustment related to incentive
14 compensation in PSE’s 2019 general rate case, standing by prior orders
15 addressing incentive pay.¹¹

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

- 18 A. Yes. In PacifiCorp’s 2005 general rate case, the Commission provided guidance

¹⁰ *WUTC v. Puget Sound Energy, Inc.*, Dockets UG-040640/ UG-040640, Order 06 ¶¶ 123, 144 (Feb. 18, 2005).

¹¹ *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-190529, et al., Order 08/05/03 ¶¶ 313-16 (July 8, 2020).

1 regarding the principles it uses when considering recovery of incentive pay:
2 “Generally, we require that an incentive payment plan provide benefits to
3 ratepayers. Under some circumstances, we have allowed in rates payments under
4 plans that have a dual benefit—to shareholders and ratepayers.”¹² The ultimate
5 issue, the Commission concluded, “is whether total compensation is reasonable
6 and provides benefits to ratepayers”¹³ The Commission has said, and
7 recently affirmed, that the Commission does not “wish to delve too deeply into
8 the Company’s management of its human resources and the manner in which it
9 determines overall compensation policy....”¹⁴ The Commission also said that it
10 inquires “only whether the compensation exceeds the market average, is
11 unreasonable, and offers benefits to ratepayers,”¹⁵ and that “[the Commission]
12 examine[s] only those factors.”¹⁶

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

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

¹² *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)).

¹³ *Id.* ¶ 128.

¹⁴ *WUTC v. Pacific Power & Light Co.*, Docket UE-100749, Order 06 ¶ 250 (Mar. 25, 2011).

¹⁵ *Id.*

¹⁶ *Id.*

1 **III. MULTIYEAR RATE PLAN ASSUMPTIONS FOR LABOR AND**
2 **BENEFITS**

3 **Q. What levels of expected labor and benefits expense have been planned in the**
4 **multiyear rate plan?**

5 A. Labor costs have been assumed at a continuation of prior actual growth, with non-
6 represented positions having merit increase growth of 3.5% per year, as described
7 in the Prefiled Direct Testimony of Joshua A. Kensok, Exh. JAK-1T. Also
8 included in the Company's Board approved financial plan are the costs of labor
9 market adjustments of \$11.4 million in operations and maintenance expense per
10 year for 2022-26. This annual amount includes adjustments to represented
11 positions, described earlier in my testimony, and expected market adjustments
12 needed for non-represented positions, including the information technology area.
13 PSE's cost of healthcare (benefits costs) has been the flex credits provided to
14 employees, which have grown slower than the trend of healthcare costs over the
15 last few years as PSE's cost sharing approach has taken effect. For example, in
16 the 2017 IBEW labor contract, PSE and labor agreed that flex credits would be
17 the greater of 80% of costs or a floor amount. In 2022, the IBEW family coverage
18 exceeded the 80% calculation and PSE expects the other employee groups to also
19 do so, which means that flex credits will grow during the multiyear rate case at
20 the healthcare trend. The Centers for Medicare and Medicaid Services predict
21 private health insurance costs in 2021-23 to grow 4.6% and during 2024-28 to
22 grow 5.0%, as shown in Exh. TMH-12. PwC's Health Research Institute analyzes

1 health care costs trends annually and predicted 7.0% growth in 2021 and 6.5%
2 growth in 2022, as shown in Exh. TMH-13. PSE includes benefit cost as a
3 component of the Labor Overhead Rate and has assumed growth of 4% for 2023
4 and 5% growth in 2024-26.

5 **IV. CONCLUSION**

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

7 A. Yes, it does.