

EXHIBIT NO. \_\_\_(MNC-1T)  
DOCKET NO. UG-040640, *et al.* (consolidated)  
2004 PSE GENERAL RATE CASE  
WITNESS: MICHELLE N. CLEMENTS

BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

Docket No. UG-040640  
Docket No. UE-040641  
(*consolidated*)

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

For an Order Regarding the Accounting  
Treatment for Certain Costs of the Company's  
Power Cost Only Rate Filing.

Docket No. UE-031471 (*consolidated*)

In the Matter of the Petition of

PUGET SOUND ENERGY, INC.

For an Accounting Order Authorizing  
Deferral and Recovery of the Investment  
and Costs Related to the White River  
Hydroelectric Project.

Docket No. UE-032043 (*consolidated*)

PREFILED REBUTTAL TESTIMONY OF  
MICHELLE N. CLEMENTS (NONCONFIDENTIAL)  
ON BEHALF OF PUGET SOUND ENERGY, INC.

NOVEMBER 3, 2004

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**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY OF MICHELLE N. CLEMENTS**

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**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY OF MICHELLE N. CLEMENTS**

**I. QUALIFICATIONS AND SUMMARY**

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

A. My name is Michelle Clements. My business address is 10885 N.E. Fourth Street, P.O. Box 97034, Bellevue, Washington, 98009-9734. I am the Vice President, Human Resources/Labor Relations for Puget Sound Energy, Inc. ("PSE" or "the Company").

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

A. Exhibit No. \_\_\_\_ (MNC-2) describes my educational and professional experience.

**Q. What are your duties as Vice President, Human Resources/Labor Relations?**

A. I am responsible for the overall management of the functions of the Human Resources and Labor Relations divisions including compensation programs, payroll, employee benefits programs, training, employee relations (including affirmative action and EEO tracking), recruiting and hiring, worker's compensation, and labor relations.

1 **Q. What is the purpose of your testimony?**

2 A. The purpose of my testimony is to respond to the positions taken by Commission  
3 Staff Witness Michael Parvinen regarding: (i) PSE's Goals & Incentive Plan and  
4 (ii) a forecast wage increase for 2005. My testimony describes PSE's variable pay  
5 program and explains how ratepayers benefit from this plan. I will also explain  
6 why the pro-forma 2005 increase for non-union employees is appropriate, and how  
7 it is necessary if PSE is to keep pace within the industry and hire and retain  
8 employees who provide high quality service to its customers.

9 **II. PSE'S GOALS & INCENTIVE PROGRAM**

10 **Q. Do you agree with Mr. Parvinen's proposed adjustment 2.07 Miscellaneous**  
11 **Operating Expenses, which addresses PSE's incentive/merit payments?**

12 A. No. I disagree with both components of Mr. Parvinen's proposed adjustment.  
13 First, I disagree with Mr. Parvinen's proposal to use the expense amount  
14 associated with the 2003 performance year incentive payout in the calculation of  
15 this adjustment rather than the expense amount associated with the twelve months  
16 ended September 30, 2003 (the test year) incentive plan costs, as prorated by the  
17 Company to include three months related to the 2002 performance year payout  
18 and nine months related to the 2003 performance year payout. The incentive plan  
19 expense for the test period most appropriately match the performance of that  
20 period. The 2003 amount, which Staff proposes to use, was the lowest payout to  
21 PSE employees in the past five years: \$2,096,420. The test period amount --

1 \$3,228,271--is more reflective of PSE's incentive payment expense history over the  
2 past five years, as shown below:

Performance Year	Total Incentive Payment
2003	\$2,096,420
2002	\$6,647,172
2001	\$2,739,730
2000	\$6,938,938
1999	\$6,714,993
Average	\$5,027,451

3 If the Commission determines that rates should not be set based on expense  
4 amounts associated with the payout made for the test year period, then the  
5 Commission should use the average expense for the past five years--\$5,027,451.

6 **Q. Do you agree with the second component of Staff's adjustment**

7 **2.07 Miscellaneous Operating Expenses?**

8 A. No. I also disagree with the second component of Staff's adjustment, which is to  
9 eliminate portions of the incentive payments that are "associated or tied to  
10 earnings." See Exhibit No. \_\_\_(MPP-1) at 12, line 10. Each goal of PSE's Annual  
11 Goals & Incentive Plan benefits ratepayers and should be included. In fact, PSE's  
12 Goals & Incentive Program is exactly the kind of program the Commission  
13 endorsed in Docket No. UG-920840:

14 The Commission believes that the expenses associated with these  
15 incentive pay plans should not be disallowed in this proceeding.

1                   The Commission does agree with Staff that some of the incentives  
2                   fall short in terms of sending employees the message that the  
3                   purpose of the program is to encourage improved service. The  
4                   Commission believes however that the company can do a far better  
5                   job in the future by creating incentives and setting goals that  
6                   advantage ratepayers as well as shareholders. Such goals might  
7                   include controlling costs, promoting energy efficiency, providing  
8                   good customer service, and promoting safety. Plans which do not  
9                   tie payments directly to goals that clearly and directly benefit  
10                  ratepayers will face disallowance in future proceedings.

11    **Q.    How does PSE's Goals & Incentive Plan benefit ratepayers?**

12    A.    PSE's plan benefits ratepayers in a number of ways. It encourages efficiency and  
13           high-quality service by focusing employees on key objectives, including efficient  
14           operation, customer service, safety, and reliability. Operational efficiency--  
15           especially as it relates to O&M costs--translates to lower rates for PSE's customers  
16           over time. The Goals & Incentive Plan also requires the Company to meet a set of  
17           Service Quality Indices (SQIs) *before* a payout based on earnings can be achieved.  
18           See Exhibit No. \_\_\_\_ (MNC-3) at 11, 12.

19           PSE's Goals & Incentive Plan differs from the incentive plans that were disallowed  
20           in the previous Commission orders cited by Mr. Parvinen. In Docket No. UT-  
21           950200, the Commission disallowed US West's incentive plan because the plan's  
22           structure permitted "financial rewards to eclipse customer service failures" thus  
23           sending "the message to employees that service quality is much less important than  
24           financial performance." *See* Fifteenth Supplemental Order at 48-49. PSE's Goals  
25           & Incentive Plan requires SQI goals to be reached before a payout is made and  
26           thus sends employees the message that service quality is of utmost importance.

1 See Exhibit No. \_\_\_\_ (MNC-3) at 11, 12.

2 PSE's Goals & Incentive Plan also differs from the incentive plan rejected by the  
3 Commission in Docket No. UE-921262, cited by Mr. Parvinen. Puget's incentive  
4 plan at that time focused on the Company's bottom line, and the bonuses were  
5 funded based on the Company's earnings per share. See Eleventh Supplemental  
6 Order at 61. PSE's current incentive plan focuses on goals that directly benefit  
7 ratepayers such as service quality, safety, reliability, and efficient operations. See  
8 Exhibit No. \_\_\_\_ (MNC-3) at 13.

9 PSE's Goals & Incentive Plan also differs from the Avista incentive plan that the  
10 Commission rejected in Docket Nos. UE-991606/UG-991607, also cited by  
11 Mr. Parvinen. In the Avista plan, the "corporate financial goals trumped customer  
12 service goals." Third Supplemental Order at 74. The Commission pointed to the  
13 fact that "Avista did not pay team bonuses when corporate earnings goals were not  
14 met, no matter how well the Company's customer service performance might have  
15 been." In contrast, PSE's Goals & Incentive Plan, for the payout period PSE has  
16 requested, allowed a payout when service quality and customer service goals were  
17 met, even when all financial goals were not met. See Exhibit No. \_\_\_\_ (MNC-3) at  
18 5, 11, 12.

19 In 2004, an additional control element was added to the Incentive Plan design that  
20 instituted a minimum financial hurdle the company must achieve before any  
21 payouts can occur on any goal. This minimum hurdle is set at a level that ensures  
22 funding is available for incentive payouts. After achieving the minimum hurdle, the

1 service quality and customer service goals must be met before an earnings  
2 incentive is achieved. For example, if service levels are not achieved and the  
3 earnings per share target is achieved, there is no payout on the earning goal. *See*  
4 Exhibit No. \_\_\_(MNC-3) at 3.

5 **Q. Do you believe an employee incentive plan with this minimum financial**  
6 **"hurdle" feature should be allowed in rates?**

7 A. Yes. The Company must achieve minimum levels of financial performance to fund  
8 a payout to employees. When the Company is facing financial difficulties, it must  
9 look to cut expenses it would otherwise have incurred, including employee  
10 bonuses. If the financial targets are not met, it also affects the Company's ability to  
11 build its equity, which affects both shareholders and customers.

12 **Q. Are there other ways in which PSE's Goals & Incentive Plan benefits**  
13 **ratepayers?**

14 A. Yes. The Goals & Incentive Plan slows the base wage growth which would occur  
15 in a compensation system with base salaries only. The Company's current plan  
16 involves significant pay at risk for all employees. The most direct benefit to  
17 ratepayers from the structure of the Goals & Incentive Plan is that total  
18 compensation is variable and dependent on the Company achieving its strategic  
19 objectives, which tie directly to service quality, safety, reliability, and efficiency.  
20 Variable pay programs like PSE's Annual Goals & Incentive Plan are an industry-  
21 wide practice and allow PSE to maintain a competitive foothold with peer



1 companies.

2 Also, a comprehensive compensation and benefit package makes PSE an attractive  
3 employer to strong, experienced talent in the marketplace. Highly motivated  
4 workers appreciate the Company's philosophy that allows them to increase their  
5 pay based on strong performance. Customers directly benefit from the  
6 contributions of a strong workforce; a workforce focused on achieving the  
7 Company's objectives and motivated to achieve strong results through their  
8 performance contributions.

9 **III. ADJUSTMENT 2.13 WAGE INCREASE**

10 **Q. Do you agree with Staff's proposed Adjustment 2.13 Wage Increase?**

11 A. No. Staff has proposed removing the pro-forma 2005 increase for non-union  
12 employees because it is not "known and measurable." See Exhibit \_\_\_\_ (MPP-1T)  
13 at 14. However, annual merit salary increases are an established industry practice  
14 among employers with non-union employees and have been consistently  
15 implemented by PSE for many years. Providing the opportunity for performance-  
16 based increases is important if PSE is to keep up with the external market and  
17 reward employees who provide high quality service.

18 **Q. What is the basis for PSE's adjustment 2.13 Wage Increase?**

19 A. Individual employee performance is calibrated and the pool of merit pay is  
20 distributed based on each employee's level of performance. As a result, an annual

1 merit pay award budget has been established each year since 1998 at 3%  
2 Company-wide for non-represented employees, which is in the lower end of  
3 competitive practice in the industry. The historic range of salary increases in the  
4 industry is from 3.0% (25<sup>th</sup> percentile level) to 4.5% (75<sup>th</sup> percentile level). The  
5 forecast industry average for 2005 falls within this range, and PSE's proposed  
6 budget is below this average. Exhibit No. \_\_\_(MNC-4) summarizes average  
7 forecast salary increases, by region and the nation, for 2005.

8 PSE must remain in a position to offer a total compensation package that enhances  
9 PSE's ability to attract strong talent, retain employees, and minimize turnover.  
10 Minimizing employee turnover is critical, as turnover can significantly impact labor  
11 costs. Turnover requires expenditures on recruiting, training, and time spent by  
12 new employees learning the job rather than performing the job. Low turnover  
13 results in maintaining an experienced, efficient workforce. PSE's proposed 2005  
14 increase for non-union employees is an important component of maintaining a  
15 competitive position within the industry and should not be removed from PSE's  
16 requested rate relief.

17 **Q. Does that conclude your testimony?**

18 **A. Yes, it does.**

19 [BA043050.011 / 07771-0089]