EXH. TMH-1T
DOCKETS UE-240004/UG-240005
2024 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-240004** **Docket UG-240005**

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF

THOMAS M. HUNT

ON BEHALF OF PUGET SOUND ENERGY

FEBRUARY 15, 2024

PUGET SOUND ENERGY

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PUGET SOUND ENERGY

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I. INTRODUCTION

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

A. My name is Thomas M. Hunt, and my business address is 355 110th Avenue NE, Bellevue, Washington 98004. 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 for PSE?

A. I have 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 PSE's human resources system and reporting on human resources information;
- Employee health and welfare benefits for all active employees;
- Retirement plans (pension and 401(k));

- Compensation for non-bargaining unit represented employees, as well as support in labor negotiations for 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 Vice President and Chief Human Resources Officer, who has overall responsibility for Human Resources.

Q. Please summarize your prefiled direct testimony.

A. In my testimony, I describe the elements of PSE's pay philosophy, which includes the compensation and benefits 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 in the labor market and PSE program design since the last rate case, including the increasing prevalence of a hybrid work model. I show that PSE's programs are market competitive and provide benefits to customers by enabling PSE to retain a skilled and engaged workforce while avoiding overpayment. I also outline the expected costs of labor and benefits during the multiyear rate period.

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

A. Pay Philosophy

Q. Please describe PSE's pay philosophy.

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

Taking a total compensation view allows PSE to communicate with employees the balance of different rewards for working at PSE, rather than focusing on a single element of compensation, such as base salary. By offering competitive pay, PSE can attract and retain talented employees. When PSE is able to retain good employees it keeps costs down, as PSE can minimize the cost of replacing and training new employees. Paying for performance is important in directing higher rewards to the strongest performers, enhancing productivity and effectiveness, and motivating talented employees to stay. Offering employee choice, predominantly in the benefits programs, enhances the value of PSE's pay package to employees by allowing them to spend more or less for the coverages that best fit their needs, as well as offering options with federal tax advantages.

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

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

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

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

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

A. PSE implements employee choice primarily in the benefits programs, where multiple plan choices are offered for medical, dental, and insurance coverage, with different employee costs. In addition, employees with spouses/domestic partners or children can determine whether to elect family coverage, or if the spouse covers family members, elect employee only coverage. PSE also implements employee choice through programs such as workforce flexibility, where non-represented employees and supervisors agree on flexible work schedule arrangements. PSE has also implemented a "hybrid" work policy that combines in-person working (at least 50% of the time) and remote working. Employees and their supervisors determine where employees will work in person, with the ability for employees to use PSE facilities closer to their homes, where applicable.

B. Compensation and Benefit Trends

Q. What trends have you seen since the last rate case?

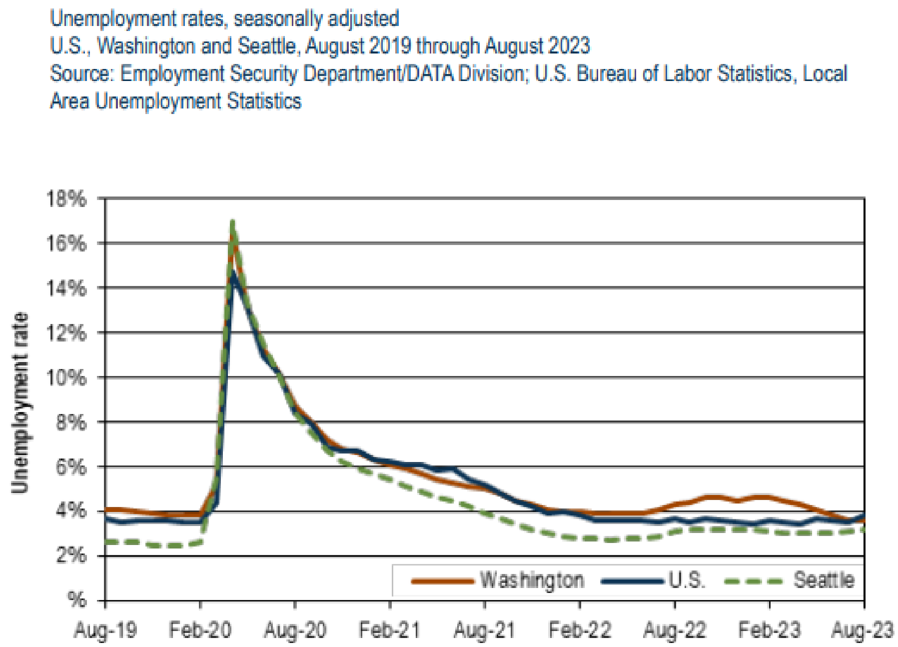
A. Some of the trends in the compensation and benefit arena since the last rate case are as follows:

1. Continued tight labor market

The region's employment has recovered from the economic shock associated with the COVID-19 pandemic as shown in the chart below from the Monthly Employment Report, Washington State August 2023.[1] Washington state's unemployment rate was 3.9% in December 2019, 5.3% in March 2020, climbed to 16.3% in April 2020, before falling to 5.0% in October 2021 and 3.6% in August 2023. In the Seattle-Bellevue-Everett area, where the majority of PSE employees work, the unemployment rates have followed a similar trajectory, although the rates started lower and look to return to levels lower than the state levels, with unemployment at 2.4% in December 2019, 5.1% in March 2020, 16.6% in April 2020, 4.9% in October 2021, and 3.2% in August 2023.

[1] Employment Security Department, *Monthly Employment Report* (Aug 2023), https://media.esd.wa.gov/esdwa/Default/ESDWAGOV/labor-market-info/Libraries/Economic-reports/MER/MER%202023/MER%20Report%20August%202023.pdf (last visited January 2, 2024).

Figure 1 – Unemployment Rates



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

2. Wage Pressures

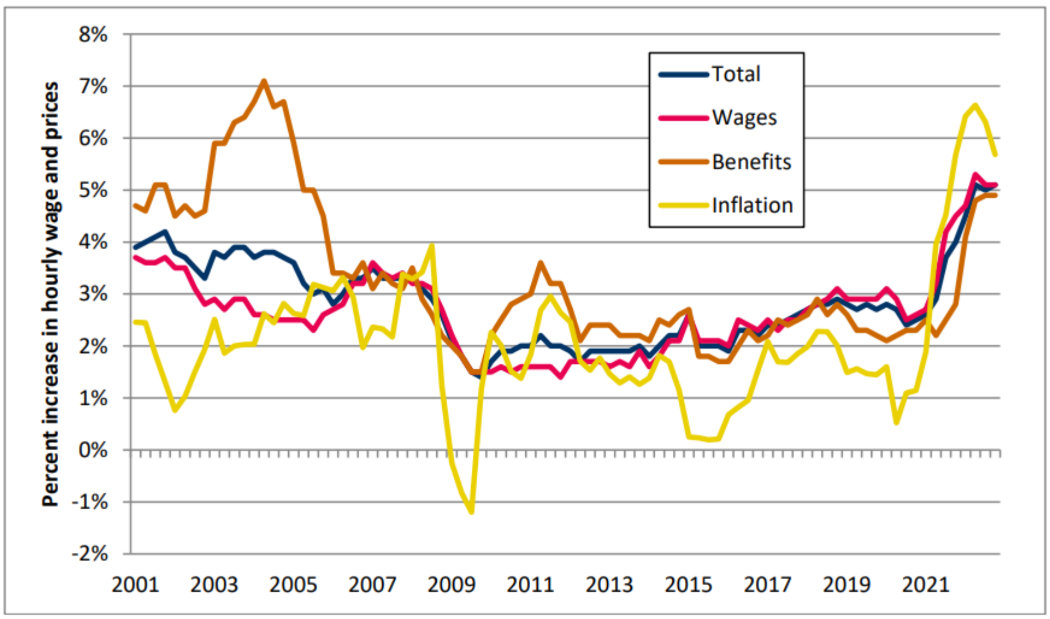
During the COVID pandemic, wage increases were modest at most companies. Since then, with continued lower unemployment, high consumer inflation, and wide-spread media coverage of union contract disputes, there has been significant pressure to raise wages. Some of this pressure has translated into higher expected pay, as will be seen belfow in my testimony regarding projected merit pay increases. Employees tend to view consumer inflation as the guide for how their salaries should change, at least when consumer inflation is high, and media attention reinforces this with articles about “real wage growth” or wage growth adjusted for consumer inflation. The figure below, from the Washington

Employment Security Department, shows recent annual changes in wage growth and inflation, with wage growth exceeding 4% for the first time since 2001, and after many years with wage growth higher than inflation.[2]

Figure 2 – Wage and Inflation

Figure 1-10. Over the year increase in total compensation, wages, and benefits for all civilian workers, not adjusted for inflation, and the rate of inflation, as measured by the U.S. Personal Consumption Expenditure Implicit Price Deflator, U.S., 2001 Q1 through 2022 Q4

Source: Employment Compensation Index, U.S. Bureau of Labor Statistics

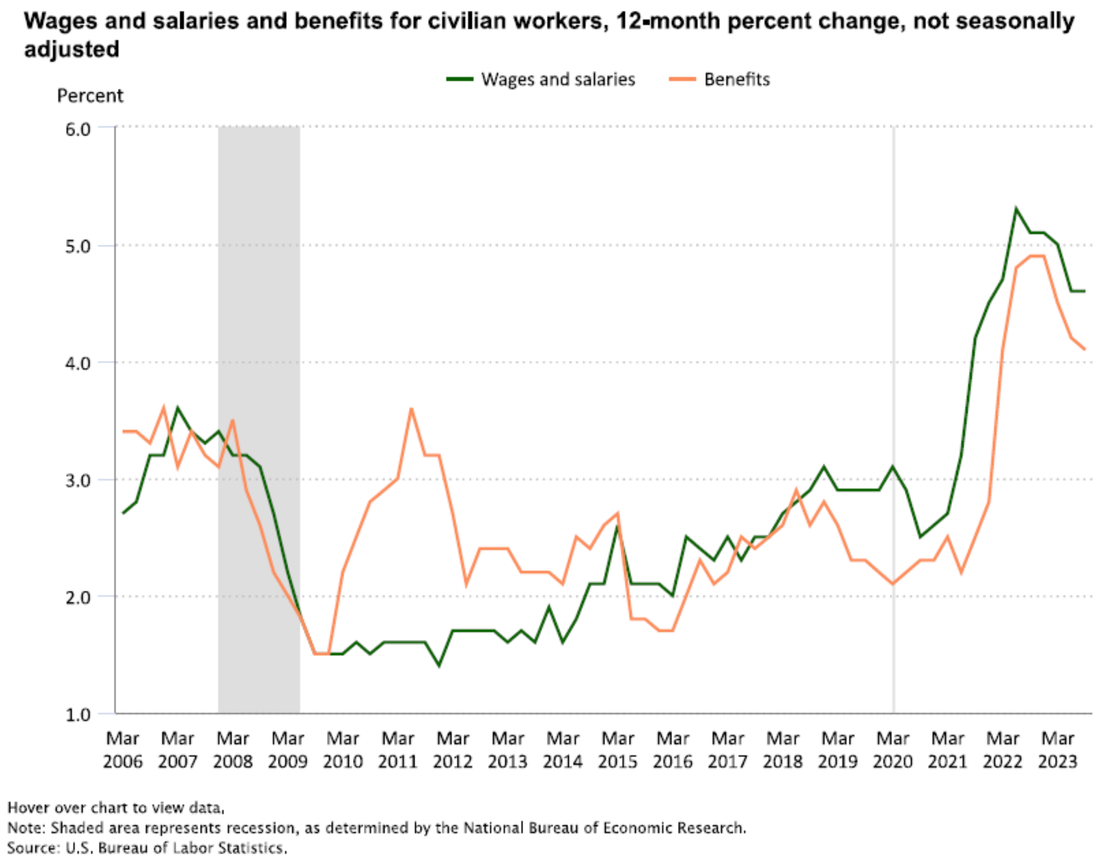


Nominal wages rose rapidly in 2021-2022, but not as fast as inflation.

[2] Employment Security Department, 2022 Labor Market and Economic Report (Aug. 2023), https://media.esd.wa.gov/esdwa/Default/ESDWAGOV/newsroom/Legislative-resources/2022-annual-economic-report.pdf (last visited January 2, 2024). Similar trends can be noted in the inflation indexes used in the Prefiled Direct Testimony of Dr. Mark Lowry, Exh. MNL-1T. Specifically, Dr. Lowry uses the PCE Price Index instead of the PCE Implicit Price Deflator and the ECI for private industry workers rather than the ECI for civilian workers featured here in Figures 2 and 3.

The figure below, from the U.S. Bureau of Labor Statistics, shows the Employer Cost Index (ECI) for wages and benefits since 2006, with significant increases since 2021, including September 2023's annual rate at 4.6%.[3]

Figure 3 – Wage and Benefit Changes



While PSE expects the wage increase levels seen in 2022 to represent a peak in values, there still are elevated levels of employment costs and wage increases.

[3] U.S. Bureau of Labor Statistics, Wages and salaries and benefits for civilian workers, 12-month percent change, https://media.esd.wa.gov/esdwa/Default/ESDWAGOV/newsroom/Legislative-resources/2022-annual-economic-report.pdf (last visited January 2, 2024).

PSE made an adjustment to salaries of non-union employees in January 2023, as described in more detail below, in part to recognize market wage pressures.

In PSE's last general rate case, PSE identified significant market increases made by local utilities for certain jobs in 2020 and 2021, as well as resulting electric craft worker adjustments PSE made in December 2021. PSE's contract covering most of the IBEW represented employees is effective from April 1, 2020, through March 31, 2026, and contains a provision for a wage opener with respect to 2024 and 2025 wages. The outcome of the negotiations of 2024 and 2025 wages is described below.

3. Impact of technology companies

Competition from technology companies continues in the King County region, as these companies continue to add jobs with high rates of pay. These jobs had an average wage before benefits of $215,600 in 2022, compared to the state average of $85,400.[4] These companies also impact the regional labor market through their support of hybrid work environments, with employees working some days in the office and other days at home or other remote locations.

According to the Washington Technology Industry Association ("WTIA"), the technology sector in the state grew by 84% between 2010 and 2019, adding 120,100 jobs. The 2022 WTIA report on the Washington technology sector, published May 31, 2023, is attached as Exh. TMH-3. During the COVID-19

[4] *Id.*

pandemic period, the region's technology sector continued to grow (+20,900 new workers in 2020) while employment in the state fell by 180,800 jobs.[5] Despite recent hiring slowdowns and some layoffs, these companies have grown and are projected to continue to grow faster than other Washington industries. "The recent layoffs, while significant, are small relative to the overall net increase in tech sector employment in Washington state. Reported ICT sector layoffs as of early May 2023 are equivalent to 15% of net job growth in the sector in 2022, bringing statewide ICT jobs back to the same job levels as April 2022."[6] The growth of the technology sector in our area is expected to continue, with forecasts of growth rates of 5% and 9% compared to 4% for Washington state overall. "According to the Washington State Economic and Revenue Forecast Council (2023), between 2022 and 2027 employment in the software publishing and e-commerce industries will increase by 5% and 9%, respectively, compared with 4% growth in nonfarm employment for the state overall."[7]

Companies in the technology sector present several challenges for PSE as they shape the competitiveness of market pay in the region. First, these companies with large hiring plans are a direct retention risk for PSE's non-utility specific jobs, in the information technology area and corporate support functions. Second, these companies operate globally and their employment brands and career development opportunities in information technology areas are difficult for a regional company

[5] Exh. TMH-3 at 15.
[6] *Id.* at 6.
[7] *Id.* at 15.

like PSE to match. And finally, these companies are less sensitive to labor costs because of their large profit margins and create wage pressure for all jobs in the area, in general, but even more acutely in situations of market shortages for roles, such as in cyber security.

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

4. Continuing high health care costs

Health care expenses have grown faster than consumer inflation in recent years and are expected to continue high growth in the future. According to a survey conducted in 2021 by WTW (formerly Willis Towers Watson), except for 2020 when the pandemic interrupted normal medical care, the underlying medical cost trend has been a 5-6% increase per year, but because of employer plan changes, employer costs have experienced an average increase per employee of approximately 4-5% per year.[8] Both the underlying trend and resulting increase per employee were substantially higher than consumer inflation in those years. Recent research by WTW indicates the cost growth could be sustained at 6%, with 2023 at 6.0% and 2024 projected to be 6.4%: "The 2023 Best Practices in Healthcare Survey found more than two-thirds of U.S. employers (69%) are focused on managing healthcare plan costs. This follows a projected cost increase

[8] 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 Jan. 2, 2024).

next year of 6.4%, compared with the average 6.0% increase employers are experiencing this year."[9]

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

A. Yes. Trends towards flexible work arrangements, which had begun prior to the COVID-19 pandemic, have greatly increased and will remain as features of the competitive labor market. For example, PSE's labor market competitors have multiplied because of jobs that can be performed remotely. Companies outside of the region could previously attract PSE employees, but only if the employee agreed to relocate. That is no longer the case; competitors can attract PSE employees without requiring relocation. While PSE does not anticipate that this trend will impact how PSE competes for talent, it adds to the other challenges within our region's competitive labor market.

After seeing the success of required work from home by many office-based employees during the COVID pandemic, PSE implemented a "hybrid" working model for many positions, where workgroups are able to determine how many days per week an employee will work in-person or remote (with "remote" meaning either at home or in a PSE location different than their main office

[9] WTW, *U.S. employers target healthcare costs and mental healthcare as they look toward 2024* (Oct. 19, 2023), https://www.wtwco.com/en-us/news/2023/10/us-employers-target-healthcare-costs-and-mental-healthcare-as-they-look-toward-2024 (last visited Jan. 2, 2024).

location.) This new approach provides up to 50% of work time remote and expands on the "employee choice" element of PSE's compensation philosophy.

C. Salary Administration

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

A. On January 2, 2023, non-union employees who were employed with PSE as of December 31, 2022, received a salary adjustment of 7.00%. On March 1, 2023, non-union employees received an average of 3.46% merit increases. Employees represented by the United Association of Journeymen and Apprentices of the Plumbing and Pipefitting Industry of the United States and Canada ("UA") union had wage adjustment of 3.5% on October 1, 2022, as stipulated in their contract that was effective October 1, 2021. Employees represented by the International Brotherhood of Electrical Workers ("IBEW") union received a 3.0% general wage increase effective January 1, 2023, as stipulated in their contract that was ratified on April 1, 2020.

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

A. As mentioned in the trends section above, employees represented by the IBEW with a contract covering the time period April 1, 2020, to March 30, 2026, had a wage opener clause for pay in 2024 and 2025. After several months of negotiation, PSE and the IBEW agreed on job classification adjustments for 2024 and general wage increases of 4% in 2024 and 4% in 2025, and IBEW members ratified the agreement on January 9, 2024. The overall wage impact of classification increases and general wage increase in 2024 is approximately 8.5%, effective January 1, 2024.

Please see the Prefiled Direct Testimony of Susan E. Free, Exh. SEF-1T, for the way in which these wage increases are incorporated into the revenue request in this filing.

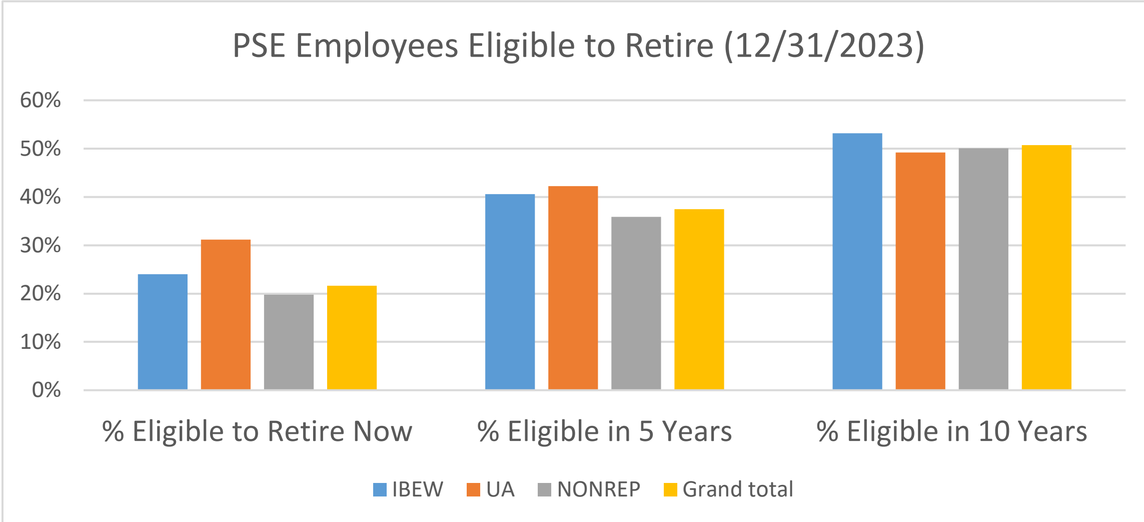
Q. How do PSE's wage increases compare to the region and the utility industry?

A. PSE's merit increases have been similar to those in the region and the utility industry. For 2022, the utility market increased salaries between 3.5% and 4.0%. Utility increases for 2023 were higher, with some participants exceeding 5.0% and 2024 projections in the 3.0% to 4.5% range. Exh. TMH-4C contains proprietary market research documenting these increases. PSE's actual non-union merit increases of 3.5% in 2022 and 3.5% in 2023, in combination with the 7.0% adjustment, are consistent with market data. PSE's union wage increases are determined pursuant to collective bargaining contracts and were similar to prior contracts. As mentioned earlier, certain qualified electric craft positions in the IBEW union received market adjustment increases in December 2021, prompted by unusual and significant pay changes at regional public utilities. Additionally, during negotiations of the IBEW contract wage opener for 2024 and 2025 wages, certain jobs were adjusted based on market and peer pay levels.

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

A. Yes. PSE has two main staffing related challenges: a continued tighter labor market than previous years and continued employee retirements. As previously discussed, a tighter labor market creates more competition for qualified employees. Additionally, PSE's employee population includes a significant proportion of employees who are currently eligible or will soon be eligible to retire, which creates a significant need for new qualified employees. More than 20% of PSE's employees are currently eligible to retire, and 41% of PSE's employees will be eligible to retire over the next five years. Significantly, over the course of the next decade, 53% of PSE's IBEW employees and 49% of its UA employees will be eligible to retire, compared to 50% of non-union employees. This will result in a significant loss of skilled workers over the next decade. Figure 4 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 slightly lower than December 2018 which was 52%, and has decreased since December 2016 when the rate was 55% for all employees.

Figure 4. 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 for key and critical roles and leadership mentoring program identify and build leaders, while its training, development, and performance management activities help employees perform effectively in their current and future roles. PSE's knowledge capture and transfer tools allow for the smooth transfer of work when employees retire or otherwise leave the company.

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

D. Executive Compensation

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

A. Officers' salaries are administered on an individual position basis and reviewed by the Compensation and Leadership Development Committee of the Board. This Committee is advised by an outside compensation consultant. PSE uses a market comparison group of similarly-sized utility companies and follows a pay-for-performance philosophy to determine competitive salaries. PSE provided extensive information about its executive compensation program in its Form 10-K filing for calendar year 2022, filed February 24, 2023, following the detailed Securities and Exchange Commission guidelines for disclosure. Please see Exh. TMH-5 for an excerpt on executive pay in 2022 from PSE's February 2023 Form 10-K filing.

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

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

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

A. PSE includes in operating costs executive compensation expenses that are related to utility operation and management for the main compensation programs, i.e., base salary, overhead for health and welfare benefits, annual incentives from PSE's Goals and Incentive Plan, qualified retirement benefits, and a portion of PSE's Long Term Incentive Plan (10%) related to Environmental, Social and Governance ("ESG") goals.

Q. What is the Long Term Incentive Plan?

A. The Long Term Incentive Plan ("LTIP") is a multiyear incentive plan for employee directors and officers in the company. The program is described in Exh. TMH-5 for the 2020-2022 LTIP cycle that completed in 2022 as well as the 2022-2024 LTIP cycle that was granted in 2022. The awards are granted as target cash awards if all goals are achieved at target levels.

Q. Why is PSE proposing to have rate payers fund a portion of the Long Term Incentive Plan?

A. Beginning with the 2023-2025 cycle of the LTIP, PSE has diversified the performance measures used, including the recognition of new goals set for PSE by Washington laws, including CETA. PSE management and the Board felt it critical to measure and incent executives for achieving important Environmental, Social and Governance ("ESG") goals, which are different from the prior LTIP goals that were largely financial. The new ESG goal provides benefits to customers by ensuring executives focus on these critical non-financial measures that are important to customers and the community. Ten percent of LTIP funding in the 2023-2025 cycle is based on achievement of reduction in carbon intensity. This portion of the 2023-2025 LTIP, and subsequent ESG measures in future LTIP cycles (which could be reduction in carbon intensity or other ESG goals), is included in this proceeding for recovery.

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

A. Investors have funded and continue to fund the majority of PSE's multiyear incentive plan, the LTIP, which is the single largest component of CEO compensation and is also a significant part of compensation for other officers. This plan is a market-competitive pay program that has been fully funded and beginning with the 2023-2025 LTIP cycle will be 90 percent funded by PSE's investors. In addition, investors fund all of Supplemental Executive Retirement Plan ("SERP") expenses. The SERP plan was closed to new participants in 2019 and an Officer Restoration Plan has been added, which provides company retirement contributions that would have been received in the pension or 401(k) plan if not limited by IRS contribution maximums.

Q. What is the estimated cost of the ESG portion of the LTIP sought for recovery in the multiyear rate plan?

A. The LTIP performance cycle is three years long and after the completion of the third year, performance is assessed and payment made in cash during March. Grants of new LTIP are made each year, so that three LTIP cycles are in process at any point in time. For example, the 2023-2025 LTIP cycle that includes an ESG measure will have performance assessed after December 31, 2025, and payment would occur in March 2026. Two other LTIP cycles will also be active on December 31, 2025—the 2024-2026 LTIP cycle and the 2025-2028 LTIP cycle. PSE accrues the expected LTIP payment for each grant during the three-year performance cycle, so one-third of the 2023-2025 LTIP cycle would be accrued in

2025, as well as one-third of the 2024-2026 and one-third of the 2025-2028 cycles. The forecast accruals pertaining to the multiyear rate plan years of 2025 and 2026 are shown on Exh. TMH-6C.

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

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

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

F. Employee Health Benefits

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

A. PSE offers a "cafeteria" benefit plan for employees. Employees have several choices as to their type of medical plan, dental plan, and life insurance, so that they can determine the best fit for their situations. PSE allots a yearly benefit amount to each employee in the form of "flexible credits," which are used monthly to pay most of the cost of benefits for employee-only coverage. Employees who elect more benefits than the allotment, or who elect for family coverage, contribute a portion of their salary to cover the additional cost. Since 2012, PSE has employed a self-insured approach, which is discussed later in my testimony and offers medical plans on a self-funded or self-insured basis through health plan providers who administer the terms of the plan. PSE offers dental and other benefits through insured arrangements with other plan providers. Since 2013, PSE has increased its emphasis on employee wellness and added a wellness internet portal and wellness credit as a way to help direct employees toward healthier behaviors and provide resources to address physical and mental health needs. Employees and spouses covered by the medical plan who reach goals for points earned through participation can receive a monthly wellness credit to offset their health care costs. Over time, the wellness plan should lead to a healthier employee population and lower medical claims, which will benefit employees, PSE, and ratepayers.

Q. What actions has PSE taken since the last rate case to control increases in medical benefits costs?

A. Employee health benefit costs at PSE, primarily medical benefits, have grown at a slower rate than other organizations, while medical costs have been higher than consumer inflation in most recent years. PSE's actions taken prior to the last rate case have helped control PSE's portion of these health benefit costs and have slowed the growth of medical costs for a number of years. Beginning with the collective bargaining agreements in 2010 and continuing with the collective bargaining agreements completed in 2017 and 2021, PSE has required employees to pay a share of monthly medical plan costs. In addition to employee cost sharing, PSE has managed benefit costs by annually reviewing plan features and implementing lower cost options for employees. Between 2019 and 2024, PSE's flexible credits and wellness credits, which represent what PSE contributes toward benefit expense, increased modestly. PSE's flexible credit costs, which match to medical plan cost trends, have had compound annual growth rates between 1.2% to 3.35%, depending on the employee group and employee or family coverage, but overall less than 3.25%. This compares to the compound growth rates of PSE's medical plans of about 5%. During these same time periods, other employers have seen annual cost increases between 5% to 6% per year, except in 2020 during COVID, according to WTW, as shown in Exh. TMH-7C.

Q. Does PSE expect its medical benefits costs to be higher in the future and how can costs be controlled?

A. Much of the growth in cost of PSE's flexible credits during the last five years occurred in 2023 and 2024, as the cost sharing levels (80% company and 20% employee) written in union contracts were fully reached. Increases in underlying plan cost (such as those for the 2024 plan year, which were finalized in fall 2023) will now result in increases to flexible credits. Accordingly, PSE expects future cost increase rates to be higher than the 3.25% per year average from 2019 to 2024 and likely around 5%, given the predictions of medical costs continuing to rise 6% per year. PSE's Benefits Team conducts market reviews of medical coverage programs and finds our existing cost sharing levels competitive in the market. Future costs will be managed through plan design modifications, in keeping with practices PSE has already been following, and also by being responsive to market levels. PSE's projections for benefits costs are included in assumptions for future years in the multiyear rate plan.

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

A. PSE adjusts employee insurance expense to the expected average cost per participant for the rate year. The average cost per participant per month for the test year based on average participant count was $1,124 for IBEW employees, $1,104 for UA employees and $1,073 for non-union employees. End of period amounts as of June 2023 and September 2023 were $1,111 and $1,166 for IBEW, $1,099 and $1,134 for UA, and $1,066 and $1,105 for non-union employees. Further discussion of this adjustment for both electric and natural gas can be found in the Prefiled Direct Testimony of Susan E. Free, Exh. SEF-1T.

Q. Why is PSE self-insured?

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

G. Retirement Plan

Q. What type of retirement plan does PSE offer?

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

PSE's "Retirement Plan for Employees of Puget Sound Energy" is a defined benefit pension plan, with two distinct formulas—final average earnings ("FAE") and cash balance. The FAE formula is the traditional type of pension, which provides a monthly payment upon retirement, but does not allow a lump sum payment of the actuarial value of the plan benefit. This plan has been closed to new employees since 2010 but remains in place for 92 active employees represented by the IBEW union, who were vested in the plan in 2005 and elected to remain on the old formula. The newer, cash balance formula is credited with annual contribution amounts and interest credits, and the retiree elects at retirement whether to receive annuity payments or a lump sum payment of the balance. The cash balance formula is sometimes termed a "hybrid" plan because, while it is still a defined benefit plan, it has features that are similar to a defined contribution plan. As shown in more detail in Table 1, below, IBEW employees hired after 2010, UA employees, and non-represented employees participate in the cash balance plan. PSE pension assets, liabilities, and company contributions are shown on Exh. TMH-8.

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

Table 1 summarizes the retirement programs available to PSE employees.

Table 1. PSE Retirement Plans

Employee Group(s)	**Pension Plan**	**401(k) Plan**
• IBEW Represented hired prior to 2010 and elected to remain in FAE plan	Final Average Earnings formula	PSE match of 55% of first 6% of employee pay contributed
• 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	• PSE contribution of 1% of base salary • PSE match of 100% of first 6% of employee pay contributed
• 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	• If cash balance not elected at hire, 4% annual company retirement contribution into 401(k) • PSE match of 100% of first 3% and 50% of next 3%
• UA Represented (hired 1/1/2014 or later)	Cash balance with 4% annual	• PSE match of 100% of first 3% and 50% of next 3%

	company contribution	

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

A. PSE made reductions in the levels of its contributions to retirement programs offered to new employees effective in 2014 and these changes continue to help manage PSE's retirement costs. For non-represented and UA represented employees, these changes were effective January 1, 2014. For IBEW represented employees, these changes were effective December 12, 2014. The level of company contribution that PSE had been making annually to its cash balance pension was changed from a sliding scale of 3% to 8% to a fixed 4%. The level of company match that PSE had been making in the 401(k) plan was changed from 100% of the first 6% of pay to 100% of the first 3% of pay and 50% of the next 3% of pay (an overall level of 4.5% match on 6% of pay). PSE reviewed industry market data on prevalence of active pension plans (i.e., defined benefit plans) and the level of total retirement contributions into pension plans and 401(k) plans. From this investigation, it became clear that the market was treating new employees differently than current employees. Based on this analysis, PSE determined that an annual maximum retirement contribution of 8.5% of pay was market competitive for new employees, and the existing plan remained appropriate for employees already in the plans, since peer organizations have also kept a two-tier design. For example, Seattle City Light changed their pension plan in 2017, effective for employees hired after January 1, 2017; and while both pre-2017 and post-2017 plans are defined benefit pension plans, the post-2017 plan has lower benefit levels. PSE monitors market information, and the level of company retirement benefit for new employees continues to be competitive. No program changes have been made since the last rate case.

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

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

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

A. Yes. The majority of utilities still use defined benefit pension plans in addition to defined contribution plans. Many utilities that have closed their defined benefit pensions to new employees still have employees hired prior to the plan close who are accruing benefits. A 2020 WTW survey demonstrates that 50% of utilities had active, defined benefit plans while 46% had closed defined benefit pension plans (with a closed plan meaning that new hires are not eligible but existing participants continue to accrue more benefits in the plan).[10] Only 4% of utilities had frozen plans (meaning they were not open to new employees and existing participants had a frozen benefit and did not accrue more benefits in the plan).[11] Additionally, public utilities in Washington, including Seattle City Light, Tacoma Power, and Snohomish PUD have active plans and continue to provide defined benefit pension plans to their new and existing employees. As noted earlier, Seattle City Light changed the terms and level of benefit of their plan for employees hired on or after January 1, 2017.

Q. What were PSE's contributions to the pension plan during 2022?

A. PSE contributed $18 million to the pension during 2022.

Q. Are PSE's contributions expected to rise or fall during 2023 and future years?

A. Pension contributions in 2023 and future years are expected to be similar to recent years.

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

A. PSE has a pension funding guideline document that establishes a range of funding each year in order to provide for long term funding of the plan. The guidelines are

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[10] 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.

[11] *Id.*

based on actuarial calculations completed by PSE's pension actuarial firm, Milliman, Inc., and require at the low end of the range that PSE contribute at least the minimum required funding per IRS regulations. At the high end of the range, PSE could contribute up to the level of maximum IRS deductible contribution; however, this high end is usually extremely high. For example, the 2023 range of contributions per the funding guidelines were $4.4 million (minimum required funding in simplified calculation) to $505.7 million (maximum IRS deductible contribution.) PSE selects a value within the range of funding guidelines, shown on Exh. TMH-9, which for 2023 was a range of $4.4 to $28.5 million, as shown on the pension funding example for 2023, prefiled as 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-8, 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 4.8% of unfunded vested liability up to a maximum of $598 per participant in 2022. The maximum for PSE’s roughly 5,350 participants would be $3.2 million for 2022 and would be higher in 2023 and beyond. These variable rate premiums are in addition to the required flat rate premiums of $88 per participant in 2022. 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 will continue to increase, as the flat rate and maximum amount of variable rate premium are indexed. For 2022 and 2023, these rates are flat rate $96 and $101 per participant and maximum variable rate of $652 and $686 per participant, respectively.

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 previously 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 that has no active employee participants) provide a pension benefit that is market competitive for executives. Without the Officer Restoration Plan or Supplemental Executive Retirement Plan, executives would not have the same retirement benefit as a percentage of their salary as non-executives. These plans continue to be a prevalent design element of executive retirement programs in the utility industry and are necessary to offer market-competitive total compensation for executives. PSE does not include the Officer Restoration Plan or the Supplemental Executive Retirement Plan costs in the amounts requested for recovery in this rate case, based on the order in Docket UE-090704.[12]

H. Goals and Incentive Plan

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

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

[12] *WUTC v. PSE*, Dockets UE-090704 and UG 090705, Order 11, ¶ 81 (April 2, 2010).

and motivate employees. The program is a variable incentive plan under which employees are eligible to receive incentive pay if PSE, team, and individual goals are achieved, and under which employees' pay is put at risk if these goals are not met. The incentive program continues to emphasize performance goals that benefit customers. Please see Exh. TMH-11 for the content of PSE's 2022 Goals and Incentive Plan, which is available to employees on the PSE's internal intranet site.

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

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

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

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

Q. How has the PSE Goals and Incentive Plan changed since the last rate case?

A. The basic plan design of the Goals and Incentive Plan has not changed since the last rate case.

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

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

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

A. Yes. Most other companies, including investor-owned utilities, follow a pay for performance approach like PSE that includes a portion of pay at risk in the form of annual incentives. By providing the opportunity for annual incentive pay based 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.

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

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

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

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

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

A. Yes. In PSE's 2004 general rate case, the Commission authorized PSE to recover incentive compensation expenses. Recognizing that a financial measure (Earnings Per Share or "EPS" at the time) was part of the program, the Commission found that "while a portion of PSE's incentive plan payments turn on PSE 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 PSE has looked for in authorizing, or not, the recovery of incentive payment costs."[13] The Commission again allowed PSE's adjustment related to incentive compensation in PSE's 2019 general rate case, standing by prior orders addressing incentive pay.[14]

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

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

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

A. Yes. In PacifiCorp's 2005 general rate case, the Commission provided guidance regarding the principles it uses when considering recovery of incentive pay: "Generally, we require that an incentive payment plan provide benefits to ratepayers. Under some circumstances, we have allowed in rates payments under plans that have a dual benefit—to shareholders and ratepayers. "[15] The ultimate issue, the Commission concluded, "is whether total compensation is reasonable and provides benefits to ratepayers . . . ."[16] The Commission has said, and recently affirmed, that the Commission does not "wish to delve too deeply into the Company's management of its human resources and the manner in which it determines overall compensation policy…."[17] The Commission also said that it inquires "only whether the compensation exceeds the market average, is unreasonable, and offers benefits to ratepayers,"[18] and that "[the Commission] examine[s] only those factors."[19]

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[15] *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)).

[16] *Id.* ¶ 128.

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

[18] *Id.*

[19] *Id.*

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

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

III. MULTIYEAR RATE PLAN ASSUMPTIONS FOR LABOR AND BENEFITS

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

A. Labor costs have been assumed at a continuation of prior actual growth, with non-represented positions having merit increase growth of 3.5% per year, as described in the Prefiled Direct Testimony of Joshua A. Kensok, Exh. JAK-1CT. Also included in PSE's Board-approved financial plan are the costs of the IBEW wage opener salary adjustment for 2024 and 2025.

PSE's cost of healthcare (benefits costs) has been the flex credits provided to employees, which have grown slower than the trend of healthcare costs over the last few years as PSE's cost sharing approach has taken effect. For example, in the 2017 IBEW labor contract, PSE and labor agreed that flex credits would be the greater of 80% of costs or a floor amount. In 2022, the IBEW family coverage reached the 80% calculation and now all groups have done so, which means that flex credits will grow during the multiyear rate case at the healthcare trend. The

Centers for Medicare and Medicaid Services predict private health insurance costs will grow 5.4% per year during the 2022-2031 time period.[20]

PwC's Health Research Institute analyzes health care costs trends annually and predicts 7.0% growth in 2024 after 6.0% growth in 2023.[21] PSE includes benefit cost as a component of the Labor Overhead Rate and has assumed growth of 5% growth for 2025 and 2026.

IV. CONCLUSION

Q. Does that conclude your prefiled direct testimony?

A. Yes, it does.

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[20] Centers of Medicare & Medicaid Services, NHE Fact Sheet, https://www.cms.gov/data-research/statistics-trends-and-reports/national-health-expenditure-data/nhe-fact-sheet (last visited January 2, 2024).

[21] PwC, Medical cost trend: Behind the numbers 2024, https://www.pwc.com/us/en/industries/health-industries/library/behind-the-numbers.html (last visited January 2, 2024).