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APPLICATION OF ENTERGY GULF
STATES, INC. FOR AUTHORITY
TO CHANGE RATES AND TO
RECONCILE FUEL COSTS §
§
§
§

BEFORE THE
STATE OFFICE OF
ADMINISTRATIVE HEARINGS

REBUTTAL TESTIMONY

OF

RICHARD N. FERGUSON

ON BEHALF OF

ENTERGY GULF STATES, INC.

MAY 2, 2008

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ENTERGY GULF STATES, INC.
REBUTTAL TESTIMONY OF RICHARD N. FERGUSON
DOCKET NO. 34800

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EXHIBITS

Exhibit RNF-R-1 Excerpts from Regulatory Agency Decisions

1 I. INTRODUCTION

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is Richard N. Ferguson. My business address is 639 Loyola,
4 New Orleans, Louisiana 70113.

5

6 Q. ARE YOU THE SAME RICHARD N. FERGUSON WHO FILED DIRECT
7 TESTIMONY IN THIS CASE ON SEPTEMBER 26, 2007?

8 A. Yes, I am. This case was filed by Entergy Gulf States, Inc. ("EGSI"),
9 based on an EGSI test year. On December 31, 2007, Entergy Texas, Inc.
10 ("ETI") succeeded EGSI as the utility responsible for retail electric service
11 in EGSI's service area. For continuity and ease of reference, and
12 because my testimony continues to refer to test year costs, I will continue
13 to use references to EGSI or to "the Company."

14

15 II. PURPOSE OF REBUTTAL TESTIMONY

16 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

17 A. I provide rebuttal testimony on behalf of EGSI regarding the following
18 issues raised by the Intervenor and Staff in their testimony filed in this
19 case:

20 1. I respond to the proposed disallowances of Staff witnesses Anna Givens
21 and Ruth Stark, Cities witness Mark Garrett, Office of Public Utility
22 Counsel ("OPC") witness Ellen Blumenthal, and Wal-Mart witness Ali Al-
23 Jabir related to EGSI's annual incentive compensation programs, long-

1 term executive incentive compensation programs, and stock option
2 programs;

3 2. I refute the claims of Cities witness Garrett and OPC witness Blumenthal
4 that EGSI's test year costs for certain supplemental executive retirement
5 benefit plans should be disallowed;

6 3. I address in part the claim of OPC witness Dr. Carol Szerszen that certain
7 project costs included within the Human Resources class of affiliate costs
8 should be disallowed because they relate to Louisiana activities; and

9 4. I rebut certain revenue requirement disallowance proposed by Staff
10 witness Givens related to relocation assistance and educational
11 assistance expenses.

12

13 Q. DO YOU SPONSOR ANY EXHIBITS OR SCHEDULES IN THIS FILING?

14 A. I sponsor the Exhibits listed in my Table of Contents.

15

16 III. ANNUAL AND LONG-TERM INCENTIVE COMPENSATION

17 A. Introduction

18 Q. WHAT IS THE POSITION OF STAFF AND INTERVENOR WITNESSES
19 REGARDING EGSI'S RECOVERY OF INCENTIVE COMPENSATION?

20 A. Staff witness Givens (incentive compensation for EGSI employees), Staff
21 witness Stark (affiliate incentive compensation charged to EGSI) and
22 Intervenor witnesses Garrett, Blumenthal, and Al-Jabir all recommend
23 disallowances related to annual incentive compensation. All of these

1 witnesses propose that annual incentive compensation amounts be
2 disallowed to the extent they relate to “financial” performance measures.
3 They further argue that 100% of EGSI’s long-term executive incentive
4 plans (including the Long-Term Incentive Plan, Restricted Share Awards,
5 and Equity Awards) be disallowed from rates.

6 Although these witnesses agree that annual incentive
7 compensation related to “operational” incentive targets should be allowed
8 in rates, Mr. Garrett and Ms. Blumenthal propose further “normalizing”
9 adjustments to further reduce the level of annual incentive compensation
10 included in rates. These adjustments substitute an amount based on an
11 averaging of annual incentive compensation payments since 2003.
12 [Garrett, page 26; Blumenthal, page 13].

13 The two Staff witnesses, Mr. Garrett, and Ms. Blumenthal further
14 argue that all stock option costs included in EGSI’s test year expenses
15 should be disallowed (note that Ms. Blumenthal discusses this issue in the
16 section of her testimony addressing employee benefits, rather than
17 incentive compensation [Blumenthal, page 18]). Mr. Al-Jabir diverges
18 from the others in the area of stock options, recommending that a portion
19 (approximately 40%) of stock option expense be treated as related to
20 operational performance and included in rates. He would disallow the
21 remainder as related to financial performance. [Al-Jabir, pages 41-42].

1 Q. PLEASE SUMMARIZE YOUR RESPONSE TO THESE PROPOSED
2 DISALLOWANCES.

3 A. The disallowances of these witnesses addressed to incentive
4 compensation should be rejected. Entergy's carefully balanced incentive
5 program design provides employees with a combination of incentives to
6 promote efficient and reliable operations, at reasonable cost, and thereby
7 produce healthy financial results, all to the direct benefit to both
8 customers and shareholders. For these reasons, all of the incentive
9 compensation requested by EGSI is a reasonable and necessary expense
10 of providing utility service.

11 As I discuss in more detail below, EGSI's proposed overall
12 compensation, including base pay, annual incentive, and long-term
13 incentive is at a level representative of the Company's ongoing
14 compensation costs, and consistent with market competitive levels.

15 Neither the Staff nor any Intervenor witness disputes that it is
16 necessary for the Company to provide overall compensation adequate to
17 compete in the employment market for qualified executives, managers,
18 and other employees with the managerial experience and technical
19 expertise necessary to run a sophisticated, complex utility business. That
20 level must include a combination of base and incentive compensation at
21 least at the market median (with the potential for higher compensation
22 based on outstanding results). EGSI's proposed compensation meets
23 these standards, particularly given the reasonably expected increases in

1 overall employee compensation in the timeframe after rates are set in this
2 case.

3 Finally, the logical outcome of the Staff and Intervenor positions
4 would seem to be that the Company should design its incentive programs
5 strictly to reward performance related to "operational" targets, and the
6 resulting incentive compensation would be considered reasonable. This
7 approach, however, would not alter the overall level of reasonable
8 compensation from the current plan design, but would simply change the
9 manner in which it is paid out. Furthermore, if the Commission in effect
10 approves an incentive-based compensation plan that is not balanced as
11 EGSI's, this action could send a policy message that the utility should
12 over-stress operational goals without consideration of the financial
13 implications of such goals.

14 In the remainder of Section III, I will address the specific claims of
15 the Staff and Intervenor witnesses regarding annual incentive
16 compensation, long-term incentive compensation, and stock options.

17

18 B. Annual Incentive Compensation

19 Q. ALL OF THE STAFF AND INTERVENOR WITNESSES ADDRESSING
20 ANNUAL INCENTIVE COMPENSATION ARGUE THAT
21 DISALLOWANCE OF SUCH COMPENSATION IS CONSISTENT WITH
22 THE COMMISSION'S DECISION IN DOCKET NOS. 28840 AND 33309.
23 WHAT IS YOUR RESPONSE?

1 A. The outcome in the two AEP cases (Docket Nos. 28840 and 33309) was
2 the result of the specific plan designs that were reviewed in those cases.
3 Those particulars are not before the Commission now, and should not
4 govern this case. Moreover, EGSI-specific precedent on incentive
5 compensation can be found in Company Docket No. 16705, where the
6 Commission found EGSI's incentive compensation "payment plans could
7 be valuable tools in managing budgets and at the same time evoking the
8 best work from employees."¹ The Commission concluded that "the
9 Company must show the incentive pay is tied to performance...", and that
10 the Company should prove in future cases that "incentive payments are
11 based on employee work product which meets performance goals."² The
12 Company has done just that in this case, and EGSI's plan design should
13 be judged on its own merit. To the extent the Commission determines
14 that the AEP precedent is applicable in this case, EGSI respectfully
15 requests re-examination of the issue in light of the particulars of its plan
16 design.

17
18 Q. CITIES WITNESS MR. GARRETT ALSO REFERENCES A NUMBER OF
19 REGULATORY JURISDICTIONS WHICH HE CLAIMS EXCLUDE FROM
20 RATES INCENTIVE COMPENSATION RELATED TO FINANCIAL

¹ Docket No. 16705 Proposal For Decision at 220.

² Docket No. 16705 Proposal For Decision at 220-221.

1 PERFORMANCE [GARRETT, PAGES 15-17]. DOES THIS TESTIMONY
2 ALTER YOUR OPINION?

3 A. No, it does not. From my review, it appears that in a number of instances,
4 the information that Mr. Garrett discusses from other jurisdictions does not
5 reflect official policy statements or orders of the other jurisdictions.
6 Moreover, there are regulatory jurisdictions that take a view contrary to Mr.
7 Garrett's. In 2007, the Nevada Public Utility Commission rejected Mr.
8 Garrett's position and allowed Nevada Power Company to fully recover its
9 short-term incentive compensation payments.³ Some jurisdictions have
10 accepted inclusion of incentive compensation in rates based on its overall
11 joint benefit to customers and shareholders. In particular, the West
12 Virginia Commission has stated:

13 • "The Commission realizes that the Company could very well do
14 away with its long-term incentive plan and instead spread the
15 money in the form of salaries....[A]t the bottom line, the
16 Commission realizes that all employees of the Company are
17 working not only to provide clean, safe, and potable water to the
18 citizens of West Virginia but are also working as employees of the
19 stockholders with an end towards maximizing stockholder wealth.

20 The incentive compensation is merely a different means of

³ Nevada Power Co., Docket No. 06-11022, Para. 160, 167-169 Nevada Public Utilities Commission (July 17, 2007). Pertinent excerpts from this and the other regulatory decisions referenced in my testimony are included in Exhibit RNF-1R to my testimony.

1 providing such motivation. To the extent employee incentives
2 result in efficiencies and/or increased productivity stockholders are
3 benefited, but eventually such benefits will be reflected in lower
4 revenue requirements and lower rates. Thus, both stockholders
5 and ratepayers benefit from increased productivity and operating
6 efficiencies.”⁴

7 Further, the Washington Commission has opined that:

8 • “Under some circumstances, we have allowed in rates payments
9 under plans that have a dual benefit—to shareholders and
10 ratepayers. We also will permit payments in stock, depending on
11 the overall nature of the plan and whether there are benefits to
12 ratepayers in terms of attracting good management for the
13 company.”⁵

14 Other jurisdictions have allowed a sharing between customers of the
15 costs associated with financially based incentive compensation.⁶ The
16 Company believes that this Commission should decide what it believes
17 constitutes sound public policy, not simply follow other agencies.

⁴ West Virginia –American Water Co., Para. 35, West Virginia Public Service Comm’n (January 2, 2004).

⁵ PacifiCorp, Docket No. UE-050684, Para. 128, Washington Utilities and Transportation Commission (April 17, 2006).

⁶ Nevada Power Co., Docket No. 06-11022, Para. 194, Nevada Public Utilities Commission (July 17, 2007)(granting utility 65% of long-term financial incentive pay); Southern California Edison Co., Docket 04-12-014, Para. 15.8, California Public Utilities Commission (May 11, 2006) (sharing executive incentive compensation 50%/50% between customers and shareholders).

1 Q. BASED ON HIS VIEW OF THE POLICIES OF VARIOUS REGULATORY
2 AUTHORITIES ON INCENTIVE COMPENSATION, MR. GARRETT
3 CONTENDS THAT THE COMPANY DOES NOT NEED TO INCLUDE
4 FINANCIALLY BASED INCENTIVE PAY IN RATES IN ORDER TO BE
5 COMPETITIVE WITH OTHER FIRMS, BECAUSE OTHER UTILITIES
6 ARE NOT ALLOWED TO INCLUDE THESE TYPES OF COSTS IN
7 RATES. WHAT IS YOUR VIEW?

8 A. Mr. Garrett's position ignores that whatever the policies or decisions of
9 other regulators may have been, as I have already explained in my direct
10 testimony, based on 2006 survey data, 80% or more of utility and energy
11 company employees, and 75% or more of employee classifications within
12 all industries provide annual incentive programs similar to Entergy.
13 [Ferguson Direct, Table 1]. Similarly, 79% of utility and energy companies
14 and 80% of all industries offer long-term incentive programs. [Ferguson
15 Direct, Table 2]. The need to compete for talent with these other firms
16 remains regardless of the regulatory actions cited by Mr. Garrett. In sum,
17 both annual and long-term incentive compensation are firmly established
18 on a wide scale as best compensation practices throughout U.S. business
19 and industry. The position promoted by Mr. Garrett reflects an antiquated
20 view of incentive compensation and this Commission should reject it as
21 such.

1 Q. SEVERAL OF THE OTHER WITNESSES URGE THAT INCLUDING
2 INCENTIVE COMPENSATION IN RATES BASED ON FINANCIAL
3 PERFORMANCE WILL ENCOURAGE BEHAVIOR CONTRARY TO THE
4 RATEPAYERS' OR THE PUBLIC INTEREST, SUCH AS: COST
5 CUTTING THAT MIGHT HAMPER RELIABILITY [AL-JABIR, PAGE 38];
6 EMPHASIZING PROFITABILITY AT RATEPAYERS' EXPENSE [AL-
7 JABIR, PAGES 38-39]; OR DISCOURAGING CONSERVATION OF
8 ENERGY [GARRETT, PAGE 11]. DO YOU AGREE?

9 A. No, I do not. The position of these Intervenor witnesses in this regard
10 ignores the fact that EGSI's annual incentive plans include a balance of
11 operational, reliability, cost containment, and earnings based incentives,
12 expressly designed to keep any one area from dominating.

13 Take for example, the annual 2006 incentive plan for Entergy's
14 transmission operations. It provides a combination of safety, operational
15 efficiency and reliability, customer service and satisfaction, and cost
16 containment measures designed in combination to provide overall high
17 quality service at reasonable cost. This combination of measures jointly
18 and equally benefits customers and shareholders. The measures include:

- 19 1. Employee and contractor workplace safety focused on reducing
20 accidents and lost time due to accidents;
- 21 2. Achievement of earnings target;
- 22 3. Containment of O&M and capital spending;
- 23 4. SAIDI and SAIFI reliability targets;

- 1 5. Customer satisfaction targets; and
2 6. Achievement of Entergy Continuous Improvement ("ECI")
3 objective.

4 It is noteworthy that under these targets, the manner in which the
5 transmission operations are incented to contribute to financial success is
6 by achievement of efficient operation and cost control that directly benefit
7 customers. Moreover, these witnesses' position further ignores the focus
8 of EGSI's plan design on provision of long-term as well as annual
9 incentives. This approach encourages pursuit of activities that result in
10 long-term financial health and operational success over short-term profits.

11 Finally, when Wal-Mart witness Mr. Al-Jabir testifies that retail rates
12 should fund only the operationally-based portion of annual incentive
13 compensation, in order to give "direct and accurate signals" for managers
14 to focus on matters of immediate benefit to customers, he demonstrates
15 that it is actually Staff and Intervenor positions that are short sighted.
16 Adoption of such an approach by the Commission would send a message
17 that could well encourage over-emphasis on operational factors, without
18 regard to financial results or cost control; in essence, to inefficiently "gold
19 plate" the utility system.

20

21 Q. ALL OF THE STAFF AND INTERVENOR WITNESSES INSIST THAT
22 "FINANCIAL" INCENTIVES (THAT IS, INCENTIVES RELATED TO
23 EARNINGS, NET INCOME, OR SIMILAR) ARE OF LITTLE OR NO USE

1 TO CUSTOMERS. MR. GARRETT GOES SO FAR AS TO SAY THE
2 MEETING OF FINANCIAL PERFORMANCE GOALS IS OUTSIDE OF
3 EMPLOYEE CONTROL. DO YOU HAVE ANY COMMENT?

4 A. Yes, I do. I firmly disagree with the position that there is a meaningful
5 distinction between "financial" performance incentive targets and
6 "operational" incentive performance targets, in terms of their benefit to
7 customers. As shown by the transmission-related incentive targets I
8 discussed earlier, in the utility business, higher earnings or net income are
9 specifically and directly the product of employee efforts to control or
10 reduce costs, operate efficiently and improve efficiency, and to provide
11 customer service and satisfaction that avoids adverse regulatory action
12 and discourages customers with other resource options from departing
13 the system. Higher earnings are achieved by better margins – *i.e.*, more
14 efficient operations, by improved performance and cost reduction. The
15 critical goal of incentives is to obtain these improved margins without
16 sacrificing quality of service. That is what a balanced incentive program
17 achieves.

18 The performance targets provided by the Company in discovery⁷
19 and attached to the testimony of the Intervenor witnesses provide many
20 such examples of this balance of incentives, such as capacity factor and

⁷ Company Response to Staff Request for Information 10-12.

1 other operational efficiency targets, budget control targets, process
2 efficiency targets, safety targets, and many others.

3

4 Q. MR. GARRETT [PAGE 12] AND MR. AL-JABIR [PAGE 39] ARGUE THAT
5 THERE IS NO NEED TO INCLUDE "FINANCIALLY" BASED INCENTIVE
6 COMPENSATION IN RATES BECAUSE THE COMPANY SHOULD BE
7 ABLE TO PAY THIS PORTION OF THE INCENTIVE OUT OF ITS OWN
8 EARNINGS. WHAT IS YOUR RESPONSE?

9 A. My understanding is that customer rates are established by the
10 Commission to be sufficient to pay the Company's reasonable and
11 necessary expenses plus provide a reasonable return to shareholders.
12 Under this approach, employees could meet earnings targets that would
13 accomplish no more than to enable the Company to realize its authorized
14 return. In this scenario, there is no return available to fund market based
15 employee compensation. If the Company were to pay the "financially"
16 based portion of incentive compensation from funds not recovered
17 through the expense component of its rates (assuming that its rates were
18 properly set) it would have no choice but to pay these expenses from out
19 of its authorized return. Moreover, I believe that the premise that earnings
20 are generated for the purpose of paying incentive compensation is false.
21 The proper use of earnings is to pay dividends to shareholders and to
22 reinvest in the business.

1 Q. CITIES WITNESS MR. GARRETT POSITS THAT PLACING
2 FINANCIALLY BASED INCENTIVE COMPENSATION IN RATES
3 PLACES CUSTOMERS AT RISK THAT INCENTIVE COMPENSATION
4 ACTUALLY AWARDED WHILE THE RATES ARE IN EFFECT WILL BE
5 LOWER, ALLOWING INCENTIVE COMPENSATION TO BE USED AS
6 AN ADDED CUSHION TO PROTECT SHAREHOLDER EARNINGS.
7 [GARRETT, PAGES 12-13] IS THIS A LEGITIMATE CONCERN?

8 A. No, it is not. The fundamental fact is that the Company needs to have
9 sufficient funds available to pay market rates for labor. As established in
10 my direct testimony, its overall annual base and incentive compensation
11 at the test year level meet that objective. The Company will continue to
12 pay a market rate of compensation, so the concern expressed by Mr.
13 Garrett is not legitimate. It makes no more sense to discount the market
14 cost of labor included in rates than it would to include less than the market
15 cost of transmission wire or transformers in rates, based on speculation
16 that at some point in the future the cost might fall below market. Such an
17 approach, moreover, is contrary to the concept that the test year is the
18 best representation of costs going forward.

19

20 Q. FINALLY, CITIES WITNESS MR. GARRETT ARGUES AGAINST
21 FINANCIALLY BASED ANNUAL INCENTIVE COMPENSATION UNDER
22 THE THEORY THAT RECEIPT OF SUCH PAYMENTS IS UNCERTAIN.
23 DO YOU HAVE ANY COMMENTS ON THIS PROPOSITION?

1 A. Yes. The Commission does not appear to have accepted this proposition,
2 since it has included at least “operationally” based incentive compensation
3 in rates in prior rate cases. Moreover, incentive compensation has been
4 paid by the Company every year for no less than the past 10 years and
5 incentive compensation is clearly a recurring expense for the Company.
6 Finally, any claim that incentive compensation is uncertain of payment
7 ignores the Company’s sustained success in the areas of reliability,
8 safety, customer satisfaction, operational efficiency and cost control, as
9 shown in the direct testimony of Mr. Joseph F. Domino, Company
10 distribution witness Mr. Jeffery F. Hulon, Company customer service
11 witness Ms. Dolores Stokes, and the Company’s various affiliate
12 witnesses. Annual incentive compensation is not properly viewed as an
13 occasional extraordinary bonus program. It is designed as part of an
14 overall compensation strategy, to place at risk a portion of compensation
15 to focus employees on meeting challenging but attainable performance
16 standards.

17

18 C. Normalization of Annual Incentive Compensation

19 Q. WHAT ADDITIONAL ISSUES DO INTERVENOR WITNESSES RAISE
20 REGARDING ANNUAL INCENTIVE COMPENSATION?

21 A. Even after excluding all “financial”-related incentives, Cities witness
22 Garrett further argues that the level of operational-related incentive
23 compensation in the test year is too high. [Garrett, pages 26-27]. OPC

1 witness Blumenthal makes a similar argument, but she applies her
2 adjustment to all of the annual incentive compensation in the test year
3 (financially and operationally based). [Blumenthal workpapers, "OPC
4 Adjustment to Test Year Incentive Compensation Expense"]. Mr. Garrett
5 bases his reduction on what he describes as an inflation-adjusted four
6 year average of annual incentive compensation costs. Ms. Blumenthal
7 describes her approach as using a four year simple average of incentive
8 compensation costs.

9 As a result, Mr. Garrett recommends a further reduction of
10 \$4,825,749 to EGSI's annual incentive compensation. [Garrett, p. 27,
11 Table 8]. Ms. Blumenthal recommends a total additional reduction of
12 \$13,234,799. [Blumenthal workpapers, Summary].

13

14 Q. DO YOU HAVE ANY CONCERNS REGARDING THESE
15 RECOMMENDATIONS?

16 A. Yes, I do. Neither of these witnesses dispute my initial testimony that the
17 overall level of annual base and incentive compensation is at the market
18 median. These witnesses completely ignore the fact that the Company's
19 proposed level of annual incentive compensation is needed to make the
20 overall annual compensation at market, as Entergy's base compensation
21 is somewhat below market. Accordingly, the total test year amount is
22 already at the level necessary to attract and retain qualified employees,

1 and the historical trends highlighted by these witnesses are irrelevant to
2 the reasonableness of the test year level.

3

4 D. Long-Term Incentive Compensation

5 Q. WHAT IS THE POSITION OF THE INTERVENOR AND STAFF
6 WITNESSES ON INCLUSION OF LONG-TERM INCENTIVE
7 COMPENSATION IN RATES?

8 A. All of these witnesses contend that the entirety of EGSI's test year costs
9 for long-term incentive compensation (within which I include Long-Term
10 Incentive Plans, Restricted Share Awards, and Equity Awards⁸) should be
11 disallowed from inclusion in the cost of service. Witnesses from the Staff,
12 Mr. Garrett and Ms. Blumenthal, also propose that all test year stock
13 option costs be eliminated. Wal-Mart witness Al-Jabir, on the other hand,
14 recommends that only the percentage of stock option costs proportionate
15 to the overall financial component of the incentive compensation be
16 disallowed.

17 All of the witnesses opposing these components of incentive
18 compensation conclude that the long-term incentive programs are merely
19 intended to promote shareholder interests and financial performance. In

⁸ Equity awards are EGSI's share of the change in market value of eligible employees' deferred compensation balances that was recognized in the test year. As the other parties address the same arguments in support of disallowing this expense as are raised with other long-term incentive compensation, the Company addresses it here.

1 addition, Ms. Blumenthal concludes that the Company did not adequately
2 explain the nature of this compensation.

3

4 Q. WHAT IS YOUR RESPONSE?

5 A. By focusing exclusively on the fact that these payments are tied to
6 financial performance (earnings, stock value), these witnesses are
7 overlooking the source of this increase in financial value – margins arising
8 from reductions in cost, in the context of the simultaneous achievement of
9 operational goals that ensure that the margin is not the result of sacrifices
10 in service. Stated differently, financial success results from the sum total
11 of achievement of operational efficiency and cost control that the
12 managers receiving these long-term incentives direct. The incentive of
13 the EGSI, ESI, and EOI managers eligible for long-term incentive
14 compensation is ultimately to direct Company employees' efforts in a
15 direction that yields higher returns and stock value through total Company
16 success that benefits customers.

17 In light of these facts, even under the Intervenor and Staff witness'
18 theory that financially based incentives should be disallowed (with which
19 the Company disagrees), their disallowances are overstated, as Mr. Al-
20 Jabir recognizes in part through his treatment of stock options. Since the
21 managers receiving long-term incentive compensation are responsible for
22 the achievement of all types of targets within their purview—operational
23 and financial—it is not reasonable to treat their long-term performance as

1 solely driven by financial considerations. Accordingly, consistent with Mr.
2 Al-Jabir's approach to split stock options between financial and
3 operational performance, and under a more consistent application of
4 Staff's and Intervenors' theory, the total disallowance for long-term
5 incentive compensation and stock options would be no more than the
6 percentage reasonably attributable to financial performance. This amount
7 would be \$8,435,629 (30.41%⁹ of the total long-term incentive
8 compensation and stock options cost of \$27,739,655).

9

10 Q. MR. GARRETT ARGUES THAT THE COMPANY'S CONTENTIONS
11 REGARDING MARKET LEVELS OF COMPENSATION ARE
12 INCONSISTENT WITH THE FACT THAT ITS LONG-TERM INCENTIVE
13 COMPENSATION IS ABOVE MARKET. WHAT IS YOUR RESPONSE?

14 A. Mr. Garrett overlooks the fact that Intervenor and Staff recommendations
15 for a total disallowance of long-term incentive compensation render that
16 aspect of the Company's employee compensation 0% of market.
17 Although the Company's long-term incentive compensation in the test
18 year was 200% of market, reducing that amount to be no more than a
19 market allowance would imply elimination of only one-half of the \$27.7
20 million total long-term incentive compensation in the test year, not the
21 entirety as proposed by Staff and Intervenors (save for Mr. Al-Jabir).

⁹ Under the Executive Annual Incentive Plan, 30.41% of the incentive is deemed tied to financial performance and 69.59% is deemed tied to operational performance.

1 Thus, if the result of this case were to limit long-term incentive
2 compensation strictly to the level necessary to allow EGSI compensation
3 to be market competitive, the disallowance of long-term incentive
4 compensation would be no more than \$13,869,827.

5 Moreover, a reduction of this level is unwarranted, because in light
6 of the Company's overall increasing labor costs, the total employee
7 compensation included in rates under the Company's proposals is at an
8 appropriate level. Consider that the test year book payroll expense for
9 EGSI, including its costs and its share of ESI and EOI payroll, is
10 approximately \$198 million.¹⁰ The \$13.9 million amount of the long-term
11 incentive compensation arguably above market is only 7% of that total.
12 Base payroll alone has increased an average amount of 3.5% in 2007 and
13 2008, and can reasonably be expected to increase an equal amount in
14 2009. These increases easily exceed the amount in test year incentive
15 compensation that exceeds the market level, even without considering
16 additional increases in payroll-related healthcare benefits cost. In these
17 circumstances of steadily rising payroll cost, the overall level of employee
18 compensation proposed by the Company, including the long-term
19 incentive, is representative of ongoing levels.

¹⁰ \$108,751,444 (EGSI Reg. Payroll) + \$48,435,163 (ESI Reg. Payroll) + \$40,363,014 (EOI Reg. Payroll).

1 Q. WHAT ABOUT MS. BLUMENTHAL'S SUGGESTION THAT THESE
2 PLANS ARE INADEQUATELY JUSTIFIED BY YOUR DIRECT
3 TESTIMONY?

4 A. I disagree. My direct testimony includes solid and persuasive evidence of
5 the nature of the plans, their prevalence in business and industry, their
6 design and their relationship to market based benchmarks.

7

8 IV. SUPPLEMENTAL EXECUTIVE BENEFIT PLANS

9 Q. WHAT IS THE ISSUE AT HAND REGARDING SUPPLEMENTAL
10 EXECUTIVE BENEFIT PLANS?

11 A. The Company provides four types of supplemental executive benefit plans
12 that are targeted for disallowance by Cities witness Garrett and OPC
13 witness Blumenthal. The plans include the Executive Income Security
14 Plan, the Pension Equalization Plan, the Supplemental Retirement Plan,
15 and the System Executive Retirement Plan. The plans are further
16 described in Schedule G-2 to the Rate Filing Package. Mr. Garrett
17 recommends disallowance of all such costs, quantifying the amount as
18 \$6,848,485. Ms. Blumenthal likewise recommends a total disallowance
19 of these costs, including that disallowance in her calculation of her
20 recommended employee benefits loader. [Blumenthal, pages 15-16].

21

22 Q. WHAT IS THE PURPOSE OF THESE PLANS?

1 A. Supplemental executive benefit plans are established for the purpose of
2 attracting, retaining, and motivating highly competent and qualified
3 executive managers. These plans provide supplemental retirement
4 benefits to account for the fact that Internal Revenue Code regulations
5 limit the level of retirement benefits that qualify for tax treatment favorable
6 to EGSI and Entergy Corporation. The existence of these supplemental
7 benefit programs allows the Company to pay retirement benefits to these
8 employees that are proportionate to the compensation they receive while
9 active in their employment. In addition, these programs provide
10 supplemental benefits beyond the amounts restricted in the qualified plan
11 to some participants to attract, retain, and motivate employees.

12 These retirement benefits are widely provided by companies within
13 the utility business sector. Accordingly, EGSI needs to offer them in order
14 to be competitive in the employment market with peer companies, and
15 thereby to retain and adequately compensate these employees in terms of
16 future retirement benefits. The 2007 survey information provided by Clark
17 Consulting indicates that provision of these types of benefits is prevalent
18 in American business and industry, with 67% of a group of representative
19 companies providing such benefits. For these reasons, I conclude that
20 the costs to EGSI of the Supplemental Executive Benefit Plans are
21 reasonable and necessary.

1 Q. WHAT IS YOUR RESPONSE TO MS. BLUMENTHAL'S CLAIM THAT
2 THE TEST YEAR LEVEL IS NOT REPRESENTATIVE OR RECURRING?

3 A. I don't understand her position. As I appreciate it, rates are to be set
4 based on the test year amount, adjusted as appropriate for known and
5 measurable changes. The amount EGSI paid in supplemental retirement
6 benefits for the test year is the product of the design of the plans and the
7 number of recipients in the plans in the test year. EGSI routinely incurs
8 costs associated with these plans, year in and year out. I am not aware of
9 any reason why the test year amount should not be used, and Ms.
10 Blumenthal suggests none.

11

12 Q. OPC WITNESS SZERSZEN SUGGESTS THAT AN ADDITIONAL
13 REASON TO DENY RECOVERY OF ESI AFFILIATE CHARGES FOR
14 SUPPLEMENTAL RETIREMENT BENEFITS IS THAT THERE IS NO
15 CAUSAL RELATIONSHIP BETWEEN THESE TYPES OF COSTS AND
16 THE ALLOCATION METHOD USED TO BILL EGSI ITS SHARE. DO
17 YOU AGREE?

18 A. No, I do not. As Dr. Szerszen's testimony indicates [Szerszen, pages 76-
19 77], allocation method LBRBILAL—labor dollars billed by ESI—is the
20 allocation method used to allocate these costs to EGSI. This method is
21 appropriate because it relates the level of benefits costs charged to EGSI
22 to the overall level of service it receives from ESI. Thus, the costs

1 allocated for these employees' benefits are properly proportionate to the
2 level of services that the employees are delivering to EGSI.

3

4 V. HUMAN RESOURCES AFFILIATE COSTS

5 Q. DR. SZERSZEN RECOMMENDS THE DISALLOWANCE OF THE
6 COSTS INCLUDED IN TWO HUMAN RESOURCES AFFILIATE
7 PROJECTS (F5PPZZ4046 AND F5PPZZ4081) ON THE BASIS THAT
8 THESE PROJECTS RELATE TO ACTIVITIES SOLELY IN LOUISIANA
9 RATHER IN TEXAS. HOW DO YOU RESPOND?

10 A. The costs in the Human Resources affiliate class are presented on a total
11 company basis—that is, they include the costs associated with the
12 operations of the Company in both Texas and Louisiana. The allocation
13 of these costs between the two states is the subject of the testimony of
14 Company witness Don Peters, whose direct and rebuttal testimony
15 explains the reasonableness and propriety of the Company's proposed
16 jurisdictional allocation.

17

18 VI. ADDITIONAL STAFF PROPOSED DISALLOWANCES

19 Q. DO YOU REBUT ANY ADDITIONAL DISALLOWANCES PROPOSED BY
20 STAFF WITNESS GIVENS?

21 A. Yes, I rebut Ms. Givens' claims that certain test year costs for employee
22 relocation assistance, signing bonuses, and educational assistance
23 should be disallowed.

1 Q. WHAT IS MS. GIVENS' POSITION ON EMPLOYEE RELOCATION
2 ASSISTANCE?

3 A. She urges [Givens, pages 17-18] that this type of expense should be
4 disallowed based on their removal from cost of service in Lower Colorado
5 River Authority Docket No. 28906. I disagree. In finding of fact no. 86 in
6 the Commission's final order in that case, it found that "LCRA's wages are
7 competitive, thus a bonus or moving allowance is not necessary to attract
8 quality personnel." In the employee market that Entergy and EGSI
9 operate in, most peer companies offer moving assistance, such
10 assistance is expected by employees, and the Company would be placed
11 at a competitive disadvantage if it did not offer it. Ms. Givens does not
12 dispute the reasonableness of the amount. In fact, benchmarking
13 provided to the Company by Cartus (a company specializing in employee
14 relocation) has determined that Entergy's average cost for a homeowner
15 relocation are approximately 15% below benchmark peers. Recovery of
16 this expense should be authorized.

17

18 Q. WHAT IS MS. GIVENS' POSITION ON EDUCATIONAL ASSISTANCE
19 EXPENSES?

20 A. She contends [Givens, pages 27-28] that the costs of the Company's
21 Executive MBA program should be disallowed because the participants
22 may include non-EGSI employees who "may or may not allocate time to
23 EGSI in the future" or may transfer to another job, such that customers

1 may not ultimately benefit from his or her services. These charges,
2 however, relate to EGSI employees and ESI or EOI employees whose
3 services are principally devoted to EGSI and the other operating
4 companies. Ms. Givens does not dispute that the program is beneficial
5 and does not claim the costs incurred directly by and/or allocated to EGSI
6 are unreasonable. Speculation about the future career paths of persons
7 involved in the program, or the degree to which they charge time to EGSI,
8 are not reasonable bases for denying recovery of these costs.

9 Also unsupported is Ms. Given's recommendation that customers
10 and shareholders share equally the cost of educational assistance
11 expense, based on her conclusion that "while I believe the cost of the
12 education assistance program can benefit ratepayers, I also note that
13 shareholders benefit equally from the program." [Givens, page 28] Her
14 argument seems to be that both shareholders and ratepayers benefits
15 from well trained and educated utility managers, so they should split the
16 cost. Under this rationale, however, all expenses of the Company would
17 need to be split equally between the customers and shareholders,
18 because all contribute to the successful operation of the utility, which
19 benefits both customers and shareholders. With all due respect to Ms.
20 Givens, this should not be the way that rates are set. Shareholders
21 provide the equity capital investment for the business and are entitled to
22 the opportunity to earn a reasonable return from the rates set by EGSI,
23 and that return should not be reduced by an additional obligation of

1 shareholders to pay the ordinary and reasonable expenses of running the
2 business, such as these.

3

4 Q. WHAT IS YOUR RESPONSE TO MS. GIVENS' RECOMMENDATION
5 THAT SIGNING BONUS EXPENSE BE DISALLOWED?

6 A. I disagree. The Company's employee recruiters have come to find,
7 particularly regarding persons entering the workforce from college, that
8 many of its competitors are offering signing bonuses in order to attract
9 employees to their firms. Given the high degree of competition in
10 recruiting such prospective employees, the Company needs the flexibility
11 to offer such signing bonuses as necessary to make employment offers
12 competitive with those of its peers. The small amount of signing bonus
13 expense included in EGSI's test year should be included in rates.

14

15 VII. CONCLUSION

16 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

17 A. Yes, at this time.

BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

Application of NEVADA POWER COMPANY)
for authority to increase its annual revenue requirement)
for general rates charged to all classes of electric customers) Docket No. 06-11022
and for relief properly related thereto.)
_____)

Application of NEVADA POWER COMPANY)
for approval of new and revised depreciation)
and amortization rates.) Docket No. 06-11023
_____)

ORDER

The Public Utilities Commission of Nevada ("Commission") makes the following findings and conclusions:

I. Procedural History

1. On November 17, 2006, Nevada Power Company ("NPC") filed with the Public Utilities Commission of Nevada ("Commission") an Application, designated as Docket No. 06-11022, for authority to increase its general rates to all classes of electric customers to reflect an increase in its annual revenue requirement for general rates and for relief properly related thereto. NPC requests an increase in annual revenues of \$172.4 million, which is approximately an 8% increase over present revenues. The impact of the Application varies by customer rate class. The proposed average impact for all residential customer classes is 12.25%.

2. Also on November 17, 2006, NPC filed with the Commission an Application, designated as Docket No. 06-11023, for approval of new and revised depreciation and amortization rates for electric operations. Specifically, the Application requests an increase to current annual depreciation and amortization expenses of approximately \$54 million. In Docket No. 03-10002, NPC sought and was granted a delay in implementing revised depreciation rates. As such, current effective depreciation rates were last set in 1991.

NPC's Rebuttal Position

152. Mr. Wood stated that the \$1.2 million in question is the actuarially determined amount required to meet the future pension benefit obligations for the employees who are affected by the severance at issue in this recommended adjustment. The \$1.2 million at issue exceeds what is currently funded by rates for these individuals. These benefits are funded by a trust. NPC has historically recovered amounts funded to the trusts through rates. As such, NPC has already included this amount in the trust funding for 2006. By depositing the funds in the trust, the funds will earn a return and revenue requirements will be reduced in future years. Further, targeted workforce reductions are recurring events. Since year 2000, NPC has incurred an annual severance cost ranging from \$157,000 in 2004 to \$2.4 million in 2002. (Exhibit 121 at 24-25; Exhibit 126; Tr. at 834-836.)

Commission Discussion and Findings

153. The severance costs at issue are early retirement pension benefit costs, not direct severance payments to the employees. It is unclear if the annual severance costs noted above that have been incurred since 2000 by NPC are similar in nature to those in question. Thus, the Commission concludes that these early retirement costs are non-recurring and should not be recovered in rates. Therefore, the Commission finds that the pension expense shall be reduced by \$1.172 million.

G. Short Term Incentive Plan ("STIP")

NPC's Position

154. Mr. Wood explained that the cash component of compensation includes both base pay and variable pay components. The STIP is NPC's variable cash compensation program. NPC seeks to recover \$6,023,000 in STIP costs. (Exhibit 3 at Statement P, p.7; Exhibit 66 at 11-12.)

155. The STIP is applicable to all employees; however, the percentage of pay at risk varies with position. The higher the position, the greater the percentage of compensation that will be at risk. The STIP is based upon a balanced scorecard concept whereby the payments to the employees are determined by the achievement of a combination of performance goals, including corporate goals, business unit goals, and individual performance goals. The performance goals are designed to benefit ratepayers. (Exhibit 66 at 12.)

156. NPC asserted that a wide body of research has demonstrated that variable pay programs such as the STIP have several benefits, including:

- 1) Economics – the plan can be aligned with performance and does not compound as base pay.
- 2) Competitive practice – the plan is an effective tool for attracting and retaining skilled employees. Further, it offers an opportunity to base income on performance to attract more high-performing employees.
- 3) Motivation – the plan motivates employees by providing group incentives, including motivating individuals to work cooperatively toward goals. The balanced scorecard is a way of expressing everybody's contribution and enables NPC to continually evaluate results.
- 4) Communication – variable pay is one of the strongest signals an entity can send to its employees in regard to what is important.

157. NPC explained that the STIP balanced scorecards are prepared quarterly and at the end of the calendar year. NPC testified that it achieved its STIP goals for 2005 and distributed checks to employees in March 2006. (*Id.* at 12-14.)

158. The 2006 STIP performance matrix weighted customer perception 35%, business unit performance 30%, and financial performance 35%. The business unit performance matrix includes financial, reliability, and safety components. Financial performance includes operation

and maintenance ("O&M") spending, capital spending, and the number of full-time equivalent employees. (Id. at Attachment Wood-6.)

159. NPC noted that in Docket No. 01-10001, the Commission approved inclusion of the STIP in rates, as the plan reasonably balanced customer service goals with financial goals. Also, the Commission approved SPPC's STIP costs for inclusion in rates in Docket Nos. 05-10003 and 05-10005. (Id. at 20-21.)

MGM's Position¹³

160. Mr. Garrett recommended that STIP costs related to reliability and customer satisfaction be denied or alternatively restricted to 50%. Because payment of bonuses under the STIP is left to the discretion of management and is based primarily on NPC's financial performance, the plan primarily benefits stockholders and should, therefore, be paid by stockholders. Also, the STIP is discretionary and cannot be considered essential for the provision of service. (Exhibit 88 at 1, 6, 13-14.)

161. If the costs of the STIP are included in rates, the amount designated for STIP will be collected, even if the chief executive officer determines earnings are insufficient to pay the STIP. As such, funds collected for the STIP in those years would inappropriately flow to stockholders. (Id. at 6.)

162. MGM stated that if the Commission decides to allow STIP, it should be restricted to the costs associated with those parts of the plan related to rewarding reliability and customer satisfaction and not financial performance. Based upon the 2006 amounts, MGM estimated this would reduce STIP costs by \$2,747,000. Approximately 50% of STIP performance payout in 2006

¹³ The Presiding Officer ruled that Exhibits 123 and 124 submitted by MGM during testimony in this phase of the hearing were accepted for purposes of cross examination only. This testimony was not accepted as independent evidence because it was not sponsored by a witness available for cross examination. As such, the other parties were unable to question the credibility of these exhibits. To accept the exhibits as evidence would likely be contrary to the Nevada Supreme Court ruling in Nevada Power Co. v. Public Utils. Comm'n, 122 Nev. Adv. Op. 72 (2006).

was related to financial performance measures. If designed properly, the 50% financial performance measures should be paid for by the financial savings. (Id. at 13-14.)

BCP's Position

163. Mr. Dittmer proposed to normalize the STIP expense by considering the average payout experienced over the last six years. In 2003, SPR made no STIP payments due to financial constraints. In the other years included in the BCP's six-year STIP average, STIP payouts as a percentage of regular straight time pay ranged from 0.0% to 8.7% for NPC. (Exhibit 59 at 62-63.)

164. The BCP did not have sufficient information to execute this calculation, but stated that it intended to calculate a six-year average of the STIP payouts to regular and straight-time pay from 2001-2006 and apply this "normalized" ratio to the test-year annualized level of regular and straight-time pay calculated by NPC as of October 31, 2006. The STIP payments would then be subtracted from the BCP's proposed normalized STIP payout to arrive at a total company adjustment. This total-company STIP payout adjustment will then be allocated to various expense and capital functions on the basis of the test year distribution of payroll, as NPC distributed its proposed payroll expense adjustment. (Id. at 64-65.)

Staff's Position

165. Ms. Pistoiresi recommended that the Commission accept NPC's request to allow recovery of calendar year 2006 STIP expenses. The Commission has expressed general support of the incentive payment plan concept as long as the plan's goal meets the regulatory requirement of reliable service at reasonable rates. Nonetheless, the Commission has disallowed recovery under certain circumstances, such as a decline in financial condition. NPC has demonstrated that the 2006 STIP goals comply with the regulatory requirements, and NPC has demonstrated that the 2005 STIP goals met the regulatory requirements and were actually paid. While NPC is not yet investment grade, NPC's financial condition has improved. (Exhibit 97 at 1, 10-11.)

NPC's Rebuttal Position

166. Sathien Arulanantham, Manager of Internal Financial Reporting, disagreed with the BCP's proposal to normalize STIP costs. STIP payments are based on current salaries. Normalizing costs over a six-year period would incorporate into rates historic salaries that have no relationship to current and future expenses. Additionally, the BCP's proposal to include the 2003 zero STIP payment for normalization purposes artificially reduces the STIP expense not only below expected expense levels but also below the test year expense level. (Exhibit 122 at 3.)

Commission Discussion and Findings

167. The Commission believes MGM's proposals are inappropriate because the consumers are beneficiaries of the STIP performance measures. The measures either directly benefit the consumer (i.e., reliable service) or indirectly benefit the consumer through rates. The two-year GRC cycle allows financial performance improvements to be included into rates.

168. With regard to the BCP's proposal, the Commission believes normalization of STIP costs in this proceeding is inappropriate. The purpose of normalization is to arrive at an expense level that is more representative of the level of ongoing costs than those which occurred in the test year. In this respect, normalization is intended to smooth the peaks and valleys of utility expenditures for purposes of setting rates. The BCP, by taking a six-year average which included a year of no STIP expenditures, created an artificially low level of expenditures. NPC's poor financial condition in 2003 prohibited STIP payments. The record in this proceeding demonstrates that the financial position has improved, and that there are many indications that it will continue to do so. Therefore, the likelihood of no expenditures for STIP in the near future seems remote and should not be considered when setting the appropriate level for STIP expenditures.

169. The Commission in Docket No. 05-10003 allowed SPPC to fully recover its costs related to STIP, citing the overall improvement of many critical aspects of SPPC's operations,

including the financial standing of SPPC. Staff noted that this was also the case for NPC. Based upon the foregoing, the Commission finds that MGM's and the BCP's adjustments are denied.

H. Supplemental Executive Retirement Plan ("SERP") and Restoration Plan

NPC's Position

170. Mr. Wood testified that NPC was seeking to recover SERP costs, which were disallowed in NPC's 2003 GRC. Recovery of SERP will increase revenue requirements by \$1,052,000. NPC asserted that SERP ensures the payment of a competitive level of retirement income to attract, retain, and motivate selected executives. SERP eligibility is "is limited to elected officers." The SERP is composed of two components: the supplemental retirement plan and the restoration plan. The restoration plan is to restore benefits not allowed under NPC's qualified retirement plan due to Internal Revenue Code limitations on benefits payable. (Exhibit 3 at Statement P, p. 8; Exhibit 66 at 1, 23-24.)

171. NPC stated that SPR's goal was to achieve a median compensation position as compared to its competitors, which would allow NPC to attract and retain qualified and motivated employees on a long-term basis. However, NPC's executive total compensation falls within the lower end of the competitive range. SERP is a competitive and normal cost of business. Based upon a database of 2004 executive benefit practices, Towers Perrin reported 96% of energy/utility companies offered SERP. Based on a similar review of a 2006 executive database, Towers Perrin reported 93% of general industry companies offer SERP. (Exhibit 66 at 24-25, Attachment Wood-8.)

172. NPC stated that, in SPPC's 2005 GRC, the Commission had disallowed 50% of the SERP costs. The Commission noted that full recovery would be premature until such time as SPPC had regained financial stability. Since then, the outlook for SPR has improved. In light of this,

attracted and retained qualified people that have benefited the consumer. NPC's executive officers are not only aware of, but also have actively demonstrated that, they are responsive to their customers. The Commission found in SPPC's 2005 GRC that full recovery of the costs for the supplemental SERP benefits would be premature until SPPC has regained financial stability.

184. Since SPPC's 2005 GRC, NPC's financial position has continued to improve. However, NPC has not achieved investment grade status from three rating agencies.¹⁵ Therefore, full recovery of SERP costs would be premature. The Commission denies NPC's request to include all the SERP accrual in rate base.

185. The Commission believes that its findings in this docket should recognize both the improved financial position since SPPC's 2005 GRC and the need to achieve investment grade status. Therefore, Commission finds that it would be appropriate to allow recovery of 65% of the supplemental SERP costs.

186. Additionally, the Commission concurs with Staff and NPC to the extent SERP costs are not included in rates, the accrued SERP liability account should be reduced, as the associated funds have not been paid by the consumer. Therefore, the Commission finds that the SERP liability account shall be reduced by \$515,000.¹⁶

I. Long-Term Incentive Pay ("LTIP")

NPC's Position

187. In January 2006, NPC adopted Financial Accounting Standards Board issued Statement No. 123(R), which changed the accounting requirements for stock-based compensation

¹⁵ In Docket Nos. 05-10024 and 10025, the Commission established the guideline to eliminate the utilities' dividend restriction. The guideline was "obtaining an investment credit rating for their senior secured debt from two of the three credit rating agencies is sufficient indicator of their investment status." Order, issued Feb. 28, 2006, at ¶ 81. The three credit rating agencies referred to were Standard & Poor, Moody's and Fitch. At the time, Dominion Bond Rating Service was not tracking the utilities.

¹⁶ This figure was calculated by taking the amount of supplemental benefits denied by the Commission (\$260,000) and dividing that number by the total SERP expense (\$1,054,000) and then multiplying the resulting number by the SERP accrued liability (\$2,087,000).

plans. The change in accounting occurred when stock-based compensation was recognized as an expense. (Exhibit 1 at Statement P, p. 3; Exhibit 65 at 1, 10.)

MGM's Position

188. Mr. Garrett recommended a revenue requirement adjustment of \$3.186 million. MGM argued that these incentives should be excluded from rates because the officers who benefit from these programs serve the interests of the shareholders and not ratepayers. (Exhibit 88 at 15.)

BCP's Position

189. Mr. Dittmer recommended decreasing NPC's LTIP expense by \$1,488,000. The BCP proposed two adjustments to NPC's LTIP request. First, the BCP normalized this rather volatile expense by taking a three-year average of such expense, which reduces LTIP expense by \$408,000. Second, the BCP proposed to eliminate one-half of the normalized (i.e., three-year average) LTIP expense as being incurred primarily for the benefit of SPR's shareholders, as indicated by the criteria for LTIP rewards, which reduces LTIP expense by \$1,080,000. LTIP performance shares, which comprise two-thirds of the shares, are awarded depending on SPR's total shareholder return compared to Dow Jones Utility Index companies (e.g., 50% of the grant if at the 50th percentile, and 150% of the grant if at the 75th percentile). The remaining one-third are non-qualified stock options, which are time vested at one-third per year over a three-year period. (Exhibit 59 at 56-61, Attachment 2 at Schedule C-11.)

Staff's Position

190. Ms. Pistoresi recommended the Commission accept NPC's stock compensation accounting change. The Financial Accounting Standards Board issued Statement No. 123(R), which required the recognition of various stock compensation plans as an expense. NPC's requested expense was developed in accordance with Statement No. 123(R). (Exhibit 97 at 8-9.)

NPC's Rebuttal Position

191. Mr. Arulanantham agreed with the BCP's position that share prices have been volatile and normalizing LTIP expense by averaging expenses over a three-year period would help reduce the impact of volatility. A three-year average reduces Nevada jurisdictional LTIP costs by \$408,000 to \$2,159,000.¹⁷ If the Commission accepts this adjustment, rate base and deferred taxes would then have to be adjusted. (Exhibit 122 at 3-5, Attachment 1.)

192. Mr. Wood disagreed with MGM and the BCP regarding recovery for the LTIP. LTIP equity awards are consistent with median industry practice. In September 2005, Towers Perrin reported 77% of public utilities provided some form of long-term incentives. Further, discontinuing LTIP would require NPC to increase other components of the total compensation package to remain competitive. Additionally, NPC's significant plant additions improving its financial performance will benefit both ratepayers and shareholders. (Exhibit 121 at 22-23.)

Commission Discussion and Findings

193. As part of GAAP, it is anticipated that the change in accounting better represents the annual costs associated with this program than the previous accounting. As recommended by Staff, the Commission accepts NPC's proposed accounting change for this program.

194. With respect to the SERP, NPC has attracted and retained qualified people that have benefited the consumer. NPC's executive officers have actively demonstrated that they are responsive to consumers. The Commission believes that its findings in this proceeding should recognize both the improved financial position of NPC and the need for NPC to achieve investment grade status. Until this objective is realized, the Commission believes that including all of LTIP would be premature. As it found with the SERP costs, the Commission finds that it is appropriate to allow recovery of 65% of the \$2,159,000 requested by NPC in its rebuttal testimony

¹⁷ The calculation for this figure is as follows: \$2,615,000 multiplied by 98.1651%. (Exhibit 121, Attachment 1.)

PUBLIC UTILITIES REPORTS — 231 PUR4th

DOCKET NO. 030569-GU
 ORDER NO. PSC-04-0240-CO-GU
 ISSUED: March 3, 2004

CONSUMMATING ORDER

BY THE COMMISSION:

By Order No. PSC-04-0128-PAA-GU, issued February 9, 2004, this Commission proposed to take certain action, subject to a Petition for Formal Proceeding as provided in Rule 25-22.029, Florida Administrative Code. No response has been filed to the order, in regard to the above mentioned docket. It is therefore,

ORDERED by the Florida Public Service Commission that Order No. PSC-04-0128-PAA-GU has become effective and final. It is further

ORDERED that this docket shall be closed.

By ORDER of the Florida Public Service Commission this 3rd day of March, 2004.

EDITOR'S APPENDIX

PUR Citations in Text

[FLA.] Re City Gas Co. of Florida, 207 PUR4th 181, Order No. PSC-01-0316-PAA-GU, Docket No. 000768-GU, Feb. 5, 2001.

[FLA.] Re Peoples Gas System, 222 PUR4th 476, Order No. PSC-03-00384-GU, Docket No. 020384-GU, Jan. 6, 2003.

Re West Virginia-American Water Company

Case No. 03-0353-W-42T

West Virginia Public Service Commission
 January 2, 2004

ORDER authorizing a water utility to increase its rates and charges by \$1.828 million, reflecting a return on equity (ROE) of 7% and an overall return of 6.63%. Commission approves

customer specific tariff items forecasted to produce approximately \$2.1 million in annual revenue, yielding a net decrease of \$283,000 in the amount that the utility must recover from all customers under its general water tariff. The decrease is allocated using an across-the-board methodology.

Commission finds that although the adopted ROE is at the lower end of the scale as presented by the parties, it adequately balances the concerns of the utility regarding investor perceptions of the riskiness of the water industry with the need to ensure that ratepayers pay a rate reflecting no more than a fair rate of return. A proposed market value adjustment to ROE is rejected as inconsistent with the commission's long-standing use of an original cost rate base.

Commission rules that affordability is not an exclusive issue that it can use to deny the utility a return on its investment, including a reasonable level of profit. Accordingly, it rejects a proposal to deny the utility a rate increase based on the claim that any increase would result in customer bills that would not be affordable.

The utility is allowed to recover test year incentive compensation expense. Commission notes that to the extent that employee incentives result in efficiencies and/or increased productivity both ratepayers and stockholders benefit.

Commission departs from its traditional practice of using a 13-month average test-year rate base to allow for terminal, or year-end treatment, of non-revenue producing/non-expense reducing plant additions. Citing concern over difficulties the utility apparently suffers in achieving its authorized ROE, sensitivity to the fact that the utility is having an ever increasing rate base but a slow increase in sales, as well as sensitivity to the large unmet water needs in West Virginia, the commission states that it is willing to consider alternative treatments to rate base in the future, including the possibility of a special experimental allowance for funds after construction for plant that is truly non-revenue producing/non-expense reducing. The utility also is authorized to depart from its 13-month average rate base to allow for the inclusion of projects undertaken to better

PUBLIC UTILITIES REPORTS — 231 PUR4th

revenue, expenses and rate base investment necessary to provide the level of service to all customers during the test year. When parties propose changes from the level of service performed during the test year offsetting changes in expenses and investment must be considered. Clearly, this starts down the slippery slope that could ultimately lead to projected test years. This Commission has expressed its preference for historic test years rather than projected test years many times in the past. While there may be instances of customers so large as to create a devastating impact on a utility requiring the Commission to recognize the loss of such customer, and make adjustments that result in at least a partially projected test year, the Commission is not convinced that such loss has occurred in this instance.

The Commission shall adopt the Staff position.

Incentive Compensation

[35] The Company argued that its Long-Term Incentive Plan is part of the overall compensation package for executives and is integral to efforts to attract and retain talented and capable individuals. Company Exhibit MAM-B at 26-27.

The Cities argued that the Company wants to build \$139,070 in additional executive compensation into its rates but such amount is not known and measurable since it is entirely based on Company performance. Additionally, bonuses awarded to executives for putting more money in shareholder pockets should be borne by shareholders, not ratepayers. Cities Initial Brief at p. 22.

The CAD argued that testimony from Company witness Miller made clear that the payments in question were made to certain management employees in furtherance of corporate financial goals. Tr. Vol I, p. 206-208. Stockholders are the primary beneficiaries when the Company's financial performance targets are met. They should be the ones who pay for executive bonuses, not ratepayers. CAD Initial Brief at p. 40.

The Commission does not find the position

of the CAD and the Cities to be persuasive. Indeed, incentive compensation is a known and measurable expense in this case. It was contained in the test year and shall be allowed for ratemaking purposes. The Commission understands the arguments made by the Cities that bonuses awarded to executives for putting more money in the shareholder pockets should be borne by shareholders, not by ratepayers. Looking at the situation from a slightly different perspective, however, it appears that it is the "incentive" and not the compensation that draws the ire of the Cities and the CAD. The Commission realizes that the Company could very well do away with its long-term incentive plan and instead spread the money in the form of salaries. In the present case, no party objected to the overall salary expense and it is unlikely that the addition of an additional \$139,070 to the current salary expense would have triggered any outrage among the parties. Furthermore, at the bottom line, the Commission realizes that all employees of the Company are working not only to provide clean, safe, and potable water to the citizens of West Virginia but are also working as employees of the stockholders with an end towards maximizing stockholder wealth. The incentive compensation is merely a different means of providing such motivation. To the extent employee incentives result in efficiencies and/or increased productivity stockholders are benefitted, but eventually such benefits will be reflected in lower revenue requirements and lower rates. Thus, both stockholders and ratepayers benefit from increased productivity and operating efficiencies.

The Commission rejects the Cities and CAD arguments and will allow the inclusion of the costs of the Long-Term Incentive Plan in the revenue requirements in this case.

Employee Insurance Expenses and OPEB Expenses

These items are contingent upon employee levels and the Capitalized Payroll Ratio. The Commission shall adjust these items consistent with its payroll decisions above.

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[Service Date April 17, 2006]

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	
TRANSPORTATION	)	DOCKET UE-050684
COMMISSION,)	
	)	ORDER 04
Complainant,)	
	)	ORDER REJECTING TARIFFS,
v.	)	AS FILED; REJECTING
	)	STIPULATION ON NET
PACIFICORP d/b/a PACIFIC	)	POWER COSTS; REJECTING,
POWER & LIGHT COMPANY	)	IN PART, AND ACCEPTING, IN
	)	PART, STIPULATION ON
	)	TEMPERATURE
Respondent.	)	NORMALIZATION
	)	ADJUSTMENT; DETERMINING
	)	COST OF CAPITAL
.....)	
)	
In the Matter of the Petition of	)	DOCKET UE-050412
)	
PACIFICORP d/b/a PACIFIC	)	ORDER 03
POWER & LIGHT COMPANY)	
)	
For an Order Approving Deferral of	)	ORDER GRANTING PETITION,
Costs Related to Declining Hydro	)	IN PART, DENYING PETITION,
Generation	)	IN PART
)	
.....)	

1 Synopsis. We reject the Company's proposed rates, because we find the Revised Protocol cost allocation methodology assigns resources to Washington which have not been proven to be "used and useful for service in this state," a statutory requirement. We also reject Staff's and ICNU's proposed modifications to the Revised Protocol, because they suffer from the same infirmity. While we find merit in power cost adjustment and decoupling mechanisms, we reject the proposals offered by the Company and NRDC, both because of the lack of an acceptable allocation method and because the proposals lack sufficient detail.

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- 121 The Company asserts that amortization is used to recover bond issuance expenses and that little, if any, stock issuance expense has already been recovered in rates.¹⁷⁰
- 122 *Discussion and decision.* We reject the Company's proposal either to capitalize or to amortize capital stock issuance expenses. The Uniform System of Accounts requires such expenses to be capitalized, rather than amortized.¹⁷¹ This required treatment constrains us from adopting the Company's amortization adjustment. While, in some circumstances, we have permitted adjustments to a Company's cost of equity to reflect issuance expenses or flotation costs,¹⁷² we cannot do so in this case because PacifiCorp did not incur such expenses in the test year, nor does the Company expect to incur such expenses in the future. Moreover, the Company admits that portions of these expenses already have been recovered. Allowing an adjustment to the cost of equity in this case would lead to the Company recovering some portion of these expenses twice.

3. Wages and Benefits (Adj. 4.10)

- 123 This group of adjustments addresses issues of incentive pay, pension contributions, the discount rate to be applied to pension and post-retirement accounts, the level of co-pays for health benefits and the escalation rate for medical benefit costs. Because we reject the Revised Protocol, we have no basis for allocating the expenses associated with wages and benefits or for adjusting rates in this case. However, we provide guidance to the parties on two of the issues: 1) The principles we will use in considering recovery of incentive pay and

¹⁷⁰ Exh. 195-T at 23 (Wrigley); PacifiCorp Initial Brief at 29.

¹⁷¹ Bond issuance costs are amortized as an interest expense under the Uniform System of Accounts, not as an operating expense. Capital stock issuance costs are booked to Account 214, which does not provide for amortization. Staff Reply Brief at 41.

¹⁷² We allowed the addition of 25 basis points to Avista's cost of equity to recover flotation costs. *WUTC v. Avista Corp.*, Docket UE-991606, Third Supplemental Order ¶ 358 (Sept. 29, 2000). However, as Staff notes, Avista issues common stock on a recurring basis. Staff Reply Brief at 42.

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2) The appropriate discount rate to apply to pension and post-employment benefits.

a) Incentive Pay

- 124 Companies provide incentive pay as an addition to base pay if the employee meets certain specified company goals. PacifiCorp includes approximately \$33.3 million in incentive compensation in its pro-forma test year expenses.¹⁷³ PacifiCorp's Annual Incentive Plan applies to over 3,000 employees and its Performance Unit Plan applies to 186 higher level employees.¹⁷⁴ Each plan contains the same components and targets, but payment under the Performance Unit Plan is in stock.
- 125 PacifiCorp asserts the base pay it offers is competitive, but is only one element of compensation. The Company contends that over 90 percent of companies combine base pay and incentive pay in compensation packages to attract talented employees, and PacifiCorp must follow suit.¹⁷⁵
- 126 Staff objects to PacifiCorp's incentive payments in either plan that relate to meeting financial targets, claiming that such payments should be borne by shareholders because they provide no benefit to ratepayers. Staff also opposes all stock incentive payments made under the Performance Unit Plan, on grounds that stock payments are inherently tied to meeting financial targets rather than to benefiting ratepayers.¹⁷⁶
- 127 Public Counsel and ICNU support disallowing some or all costs for incentive plans, asserting the Company has not shown them to benefit ratepayers and that the Company currently provides competitive salaries.¹⁷⁷

¹⁷³ Exh. 193, Tab 4, 4.10.5; Exh. 301-T at 15-16 (Selecky).

¹⁷⁴ PacifiCorp Initial Brief at 21; Exh. 631-T at 19-23 (Schooley); Exh. 301-T at 15-16 (Selecky).

¹⁷⁵ PacifiCorp Initial Brief at 21-22.

¹⁷⁶ Staff Initial Brief at 58-60.

¹⁷⁷ Public Counsel Initial Brief at 21-22; Exh. 291-T at 16-17 (Effron); ICNU Initial Brief at 54.

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128 **Discussion and decision.** 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.¹⁷⁸ We also will permit payments in stock, depending on the overall nature of the plan and whether there are benefits to ratepayers in terms of attracting good management for the company.¹⁷⁹ The ultimate issue is whether total compensation is reasonable and provides benefits to ratepayers, not whether incentive compensation is paid in stock or whether compensation, particularly for executives, is similar to that of other comparable companies.

b) Discount Rate for Pension (FAS 87) and Other Post-employment Benefits (FAS 106)

129 PacifiCorp's total actual pension expense for 2005 is \$49,854,892 pursuant to Financial Accounting Standard (FAS) 87.¹⁸⁰ ICNU proposes a total system FAS 87 expense of \$41.1 million. ICNU calculates its proposed expense level using a discount rate of 6.25 percent, while PacifiCorp uses a rate of 5.75 percent.¹⁸¹ ICNU contends the higher discount rate correlates better with Dr. Hadaway's projection of significant interest rate increases.¹⁸² Dr. Hadaway projects a 90-basis point increase in current Treasury security rates from 4.3 percent to 5.2 percent. ICNU asserts, in this light, a 50-basis point increase in the discount rate applied to pension expense is justified. ICNU proposes calculating other post-employment benefit expenses under FAS 106 using the same 6.25 percent discount rate.

¹⁷⁸ *WUTC v. Puget Sound Energy, Inc.*, Dockets UG-040640, UE-040641, UE-031471, UE-032043, Order 06 at 55, ¶ 144 (Feb. 15, 2005).

¹⁷⁹ *WUTC v. Avista Corp.*, Dockets UE-991606 & UG-991607, Third Supplemental Order ¶ 260 (Sept. 29, 2000).

¹⁸⁰ PacifiCorp initially proposed to use a rounded number of \$49.9 million for this expense but agreed instead to use the slightly lower, actual number. *See* Exh. 237-T at 1 (Rosborough). Similarly, the Company accepts Staff's reduction of FAS 106 expenses to \$24,026, 898.

¹⁸¹ ICNU Initial Brief at 52-53.

¹⁸² Dr. Hadaway is the Company's cost of capital witness.

This workpaper contains information that is confidential and will be provided under the terms of the Protective Order (Confidentiality Disclosure Agreement) entered in this case.

Source	Category	Code	Description	Wages	EOI	EGSI
PRL	PAYROLL	003	Salaries & Wages - Exempt	Y	EOI	EGSI
PRL	PAYROLL	004	Salaries & Wages - Non-Exempt	Y	EOI	EGSI
PRL	PAYROLL	005	Salaries & Wages - Bargaining	Y	EOI	EGSI
PRL	PAYROLL	006	Salaries & Wages - Part Time	Y	EOI	EGSI
PRL	PAYROLL	703	Loaned Labor-Exempt	Y	EOI	EGSI
PRL	PAYROLL	704	Loaned Labor - Non Exempt	Y	EOI	EGSI
PRL	PAYROLL	705	Loanded Labor - Bargaining	Y	EOI	EGSI

Amount	Answer
26,417,191	yes
465,494	yes
12,170,498	yes
140,773	yes
511,242	yes
201,368	yes
456,448	yes
40,363,014	

Sample	Sampling	Period	Description	Y/N	ESI	EGSI
PRL	PAYROLL	003	Salaries & Wages - Exempt	Y	ESI	EGSI
PRL	PAYROLL	004	Salaries & Wages - Non-Exempt	Y	ESI	EGSI
PRL	PAYROLL	005	Salaries & Wages - Bargaining	Y	ESI	EGSI
PRL	PAYROLL	006	Salaries & Wages - Part Time	Y	ESI	EGSI
PRL	PAYROLL	703	Loaned Labor-Exempt	Y	ESI	EGSI
PRL	PAYROLL	704	Loaned Labor - Non Exempt	Y	ESI	EGSI
PRL	PAYROLL	705	Loanded Labor - Bargaining	Y	ESI	EGSI
PRL	PAYROLL	706	Loaned Labor -Part Time	Y	ESI	EGSI