SOAH DOCKET NO. 473-19-3864
PUC DOCKET NO. 49421

APPLICATION OF CENTERPOINT	§	BEFORE THE STATE OFFICE
ENERGY HOUSTON ELECTRIC, LLC	§	OF
FOR AUTHORITY TO CHANGE RATES	§	ADMINISTRATIVE HEARINGS

REBUTTAL TESTIMONY

OF

JOHN J. REED

ON BEHALF OF

CENTERPOINT ENERGY HOUSTON ELECTRIC, LLC

June 2019

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REBUTTAL TESTIMONY OF JOHN J. REED

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is John J. Reed. I am President and Chief Executive Officer of Concentric Energy Advisors, Inc. ("Concentric") and CE Capital Advisors, Inc. ("CE Capital"), which has its headquarters at 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?

A. I am testifying on behalf of CenterPoint Energy Houston Electric, LLC ("CenterPoint Houston" or the "Company").

Q. ARE YOU THE SAME JOHN J. REED WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I will respond to the direct testimonies of Public Utility Commission of Texas ("Commission") Staff witness Mark Filarowicz, Texas Industrial Energy Consumers ("TIEC") witness Billie S. LaConte, Office of Public Utility Counsel ("OPUC") witness June M. Dively, and City of Houston and Houston Coalition of Cities ("COH") witness Mark E. Garrett.

Q. PRIOR TO RESPONDING TO THE AFOREMENTIONED STAFF AND INTERVENOR WITNESSES, PLEASE SUMMARIZE THE SCOPE AND FINDINGS OF YOUR DIRECT TESTIMONY.

A. In my direct testimony I provided an overview and assessment of CenterPoint Energy Houston Electric, LLC's ("CenterPoint Houston" or the "Company") compensation practices. I also opined on the reasonableness of the Company's overall compensation practices and the inclusion of the total compensation costs, including both short- and long-term incentives, in the rates to be established in this proceeding. I concluded that CenterPoint Houston's total compensation package is reasonable and consistent with the market and that the use of short- and long-term incentive compensation was appropriate and consistent with that offered by other companies against which CenterPoint Houston competes for resources, and that these practices benefit the Company's customers. I also recommended that CenterPoint Houston be allowed to include the entirety of its compensation expenses in the cost of providing services that will be used to establish rates in this proceeding.

Q. AFTER REVIEWING THE AFOREMENTIONED TESTIMONIES OF THE OTHER PARTIES TO THIS PROCEEDING HAS YOUR POSITION CHANGED?

A. No, it has not.

II. RESPONSE TO DIRECT TESTIMONY OF STAFF, TIEC, OPUC AND COH WITNESSES

Q. PLEASE SUMMARIZE THE POSITIONS OF STAFF WITNESS FILAROWICZ, TIEC WITNESS LACONTE, OPUC WITNESS DIVELY AND COH WITNESS GARRETT.

A. The recommendations of the Staff and intervenor witnesses are largely the same although the quantification of the recommended adjustments vary.

Staff witness Filarowicz recommends the disallowance of $33.47 million of what he refers to as CenterPoint Houston's financially based incentive compensation as well as half (or $2.327 million) of the expense for non-financially based incentive compensation included in the Company's request, for a total proposed adjustment of $35.8 million.

Ms. LaConte recommends the disallowance of $31.6 million of incentive compensation expenses consisting of 69 percent of the test year short-term incentive ("STI") expenses and 100 percent of the test-year long-term incentive ("LTI") expenses.[1]

Ms. Dively concludes that $12.6 million or 82.86 percent of the employee goals in the STI plan are financially based goals and should be removed from the Company's cost of service[2] and that $12.1 million of LTI plan costs be disallowed[3], for a total proposed disallowance of $24.7 million.

Mr. Garrett proposes to exclude $14.8 million of STI costs[4] and $11.25 million of LTI plan costs for a total proposed adjustment of $26.1 million.[5]

Q. WHAT ARE THE REASONS THAT THESE WITNESSES PROVIDE TO SUPPORT THEIR RECOMMENDATIONS?

A. While the parties cannot apparently agree upon which aspects of the plans are considered "financial" goals as well as the amount of STI and LTI costs included in the test year, each of the witnesses assert that the STI and LTI plans primarily benefit shareholders, not CenterPoint Houston customers.

Q. DO YOU AGREE?

A. I do not.

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[1] Direct testimony of TIEC witness Billie S. LaConte, p. 19, lines 22-23.
[2] Direct testimony of OPUC witness Dively, p. 45, lines 3-4.
[3] *Id.*, p. 44, line 16.
[4] Direct testimony of COH witness Garrett, p. 32, line 9.
[5] *Id.*, p. 42, line 5.

Q. HOW DO CUSTOMERS BENEFIT FROM THE COMPANY'S STI PLAN?

A. As I described in my direct testimony, customers are primarily concerned about the safety and reliability of electric service, responsiveness of the Company to complaints and issues, and the value of services provided by the Company. These are primarily the goals against which the Company's and its employees' performance are evaluated under the existing STI and LTI compensation plans. The metrics monitored to determine STI payments include customer satisfaction, safety, O&M expenditure management, operating income, and earnings per share. These include factors that are of the utmost importance to customers – safe, reliable service, and responsive customer service at a reasonable price.

Q. HOW DOES OPERATING INCOME AND EARNINGS PER SHARE BENEFIT THE CUSTOMER?

A. Controlling operating expenses has a direct and dollar-for-dollar impact on operating income. Earnings per share flow from operating income. By controlling operating expenses, future rate increases can be avoided or at a minimum delayed. Clearly customers directly benefit from controlled expenses, and the byproducts of effective expense control, such as higher operating income, are no different.

Q. HOW DOES THE COMPANY'S LTI PROGRAM BENEFIT ITS CUSTOMERS?

A. As explained in the direct testimony of Ms. Harkel-Rumford, the LTI plan is designed to focus the efforts of participants on sustained improvements in CenterPoint Energy, Inc.'s ("CNP") and the Company's performance over a longer period of time, typically three years. The LTI plan is also designed to retain high-performing employees over time to maintain continuity of the management team.

LTI pay is a variable compensation component that rewards participants with shares of CNP stock based on achievement of goals measured over three-year overlapping periods. The 2018 goals were based on total shareholder return and net utility income. As with STI goals, LTI focuses on the retention of the senior management team as well as factors that directly benefit customers, namely cost controls, which as I previously explained directly benefit customers. So, in the end, customers, shareholders and employees all benefit from sustained improvements in the Company's performance.

Q. HAVE YOU REVIEWED COMPANY WITNESS HARKEL-RUMFORD'S REBUTTAL TESTIMONY REGARDING THE PROPER TREATMENT OF THE COSTS ASSOCIATED WITH RESTRICTED STOCK UNITS IN THE COMPANY'S LTI PLAN?

A. Yes, I have.

Q. DO YOU AGREE WITH COMPANY WITNESS HARKEL-RUMFORD ON THE PROPER TREATMENT OF THE RESTRICTED STOCK UNITS?

A. Yes, I do. As Company witness Harkel-Rumford explains, since the restricted stock units are issued as a form of compensation that vests after three (3) years of service, and are not based upon achievement of any goals, these are reasonable and necessary costs that should be recoverable in rates.

Further, I view restricted stock awards as a retention vehicle designed to focus on the longer-term retention of key employees, which ensures continuity of leadership for the Company. Given that restricted stock awards are not based upon attaining financial metrics, I recommend that the cost of restricted stock units should be allowed to be recovered in rates.

Q. HAS THE COMMISSION PREVIOUSLY AGREED WITH THIS PROPOSED TREATMENT OF RESTRICTED STOCK UNITS?

A. Yes. The Commission has allowed recovery of restricted stock units that are included in long-term incentive compensation plans. In the Order on Rehearing in the Southwestern Electric Power Company (SWEPCO) 2014 rate case, the Commission allowed recovery of restricted stock units in SWEPCO's long-term incentive compensation plan.[6] In its Order in PUC Docket No. 46449, the Commission concluded that restricted stock units were not based on financial measures as were other SWEPCO or AEP incentive plans and were appropriate to include in SWEPCO's rates.[7]

Q. WHAT IS THE BASIS FOR STAFF WITNESS FILAROWICZ'S PROPOSED ADJUSTMENT TO THE COMPANY'S INCENTIVE COMPENSATION COSTS?

A. Staff witness Filarowicz states that his proposed adjustments "align with long-standing and recent Commission precedent on incentive compensation."

Q. DO YOU AGREE WITH STAFF WITNESS FILAROWICZ'S JUSTIFICATION FOR HIS PROPOSED ADJUSTMENTS?

A. No, I do not.

Q. PLEASE EXPLAIN.

A. Finding of Fact 81 in this Commission's Final Order in Docket No. 38339 stated, "The evidence demonstrates that CenterPoint's short-term compensation plan (STI) is a reasonable and necessary component of a total compensation package required

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[6] *Application of Southwestern Electric Power Company for Authority to Change Rates,* Docket No. 46449, p. 35, Finding of Fact 199 (January 11, 2018).
[7] *Id.*

to recruit, retain, and motivate employees."[8] Finding 83 further stated, "The corporate and financial goals of STI are directly tied to metrics such as customer service and safety."[9] Therefore, the Commission's final order does not support Staff witness Filarowicz's proposed adjustment.

Q. BEGINNING ON PAGE 20 OF HIS DIRECT TESTIMONY, DOES MR. GARRETT OFFER HIS OPINIONS AS TO THE "GENERAL RATIONALE FOR EXCLUDING INCENTIVE COMPENSATION TIED TO FINANCIAL PERFORMANCE"?

A. Yes, he does.

Q. WHAT IS MR. GARRETT'S FIRST GENERAL RATIONALE FOR EXCLUDING INCENTIVE COMPENSATION TIED TO FINANCIAL PERFORMANCE?

A. The first rationale is that payment is uncertain because the actual incentive payout may vary from year to year.

Q. HOW DO YOU RESPOND TO MR. GARRETT'S "RATIONALE"?

A. As a threshold matter, payment is not uncertain. Mr. Harkel-Rumford addresses CenterPoint Energy's historical incentive compensation awards in her rebuttal testimony. Next, the statement highlights a fundamental difference between Mr. Garrett's view and established ratemaking principles. A company's development of rate base and operating expenses for purposes of a rate proceeding does not include certainty that a specific expense will be incurred, or that a specific investment in rate base will be made. The concept of ratemaking is that rates are

[8] *Application of CenterPoint Electric Delivery Company, LLC, for Authority to Change Rates*, Docket No. 38339, p. 22, Finding of Fact 81 (June 23, 2011).
[9] *Id.*, Finding of Fact 83.

established on test year operating expenses and plant in service expenditures expected to be incurred during a period following the approval of new rates. A regulatory commission does not approve each expense or investment in rates, it approves a level of costs in rates. Rather, a revenue requirement is the summation of rate base expenditures and O&M expenses for the test period. There is no implied certainty that the specific costs will be incurred, rather the costs are deemed reasonable based upon the Company's historical activities/investments.

Further, while relative difficulty in estimating an expense level may affect the amount of the allowed expense, it does not provide a basis for excluding the cost from rates, which has the same effect as assuming that the expense is zero, which is an altogether unreasonable assumption.

Q. WHAT IS MR. GARRETT'S SECOND "RATIONALE"?

A. Mr. Garrett proffers that many of the goals in an incentive program are outside the control of most employees, particularly those that affect earnings, and he provides examples related to weather, customer growth, and return on equity.

Q. HOW DO YOU RESPOND?

A. I do not concur that these assertions provide any basis for disallowing the Company's STI and LTI expenses. There is no dispute that weather can vary and can impact the Company's earnings. Such an impact can swing both ways. If weather is hotter than normal, deliveries may exceed forecasts. If weather is cooler than normal, deliveries may fall short of forecasts. Similarly, if the electric grid is seriously impacted by a weather occurrence, the Company's financial performance may be negatively impacted. Again, the rates established in a rate proceeding are intended to depict a normalized level of costs. The level of expenses approved by the Commission in a rate proceeding is not intended to provide assurances that actual costs will match the test year levels.

Q. WHAT IS THE THIRD BASIS OFFERED BY MR. GARRETT TO SUPPORT HIS RECOMMENDATION THAT THE COMMISSION SHOULD EXCLUDE INCENTIVE COMPENSATION COSTS?

A. Mr. Garrett proffers that earnings-based incentive plans can discourage conservation.

Q. HOW DO YOU RESPOND?

A. In my experience, most conservation programs are either State or Commission mandated, and/or implemented due to system constraints. Further, I believe that most consumers have become well-versed in efforts to reduce energy consumption and reduce their energy bills. In my opinion, I believe that it is quite a stretch for Mr. Garrett to suggest that the Company would slow or eliminate efforts to negatively impact conservation efforts.

Q. WHAT IS MR. GARRETT'S NEXT ARGUMENT?

A. Mr. Garrett argues that the utility and its stockholders assume no financial risk associated with incentive payments.

Q. HOW DO YOU RESPOND?

A. Stockholders absorb exactly the same risk with this element of the revenue requirement that they do with every other element. Stockholders absorb the risk that the allowed rates will be inadequate, or more than adequate, to earn the allowed return. The allowed rates are derived from the revenue requirement, which reflects all expected costs. Mr. Garrett's point is correct that employees bear some risk of achieving the incentive compensation goals, as employees in any organization do.

That fact has no bearing on whether these costs are appropriate for inclusion in the revenue requirement, particularly when they are part of an overall compensation plan that is reasonable and geared towards the median of the market.

Q. WHAT IS MR. GARRETT'S NEXT ARGUMENT?

A. Mr. Garrett proffers that incentive payments based on financial performance should be funded out of increased earnings.

Q. HOW DO YOU RESPOND?

A. He appears to misunderstand the Company's compensation plan. His position suggests that in high earning years, incentive compensation can be funded out of the high earnings. The Company's compensation plan does not freeze compensation until the Company earns above its allowed return on equity, and there is no tie to earned return. The Company's practice is to compensate its employees at the 50th percentile of the market based on total compensation, based on achieving reasonable goals for operations, customer service, cost control and the income derived from these cost controls. This includes the payment of any incentive compensation payments. Mr. Garrett's position offers no basis for excluding these costs from rates.

Q. WHAT IS MR. GARRETT'S NEXT ARGUMENT?

A. Mr. Garrett's sixth argument is that incentive payments embedded in rates shelter the utility against the risk of earnings erosion through attrition.

Q. HOW DO YOU RESPOND?

A. Mr. Garrett's sixth argument is partially duplicative of his last argument that I addressed. As I stated earlier, this Commission will approve rates in this proceeding, based on a test year revenue requirement and set of billing determinants. There are no "embedded amounts for incentive payments" that will be maintained in a fund for later distribution if defined goals are met. There is no fund that the utility can raid for the purposes of offsetting potential earnings attrition. The actual earnings derived from customers paying the approved rates will be based upon actual energy usage, actual expenses, and actual investments. The rates should be derived from a revenue requirement that includes a reasonable level of what incentive compensation payments will be, just as is done for all other reasonable and necessary expenses.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING MR. GARRETT'S CONCERNS RELATED TO HOW THE COMPANY COULD BENEFIT FROM THE INCLUSION OF INCENTIVE COMPENSATION AMOUNTS IN RATES.

A. Mr. Garrett offers no basis for treating the incentive compensation costs any differently from all other reasonable and necessary costs. The Company's requested incentive compensation amounts are reasonable and necessary to compensate the Company's employees at the midpoint of the market in terms of total compensation. And, as Ms. Harkel-Rumford explains in her direct and rebuttal testimony, the total cash compensation CenterPoint Energy offers in the form of base pay plus short-term incentive pay is at or below that median. Mr. Garrett has obviously given much thought to speculating about the various ways the Company could misuse a "slush fund" of incentive compensation dollars if the Commission approves the requested inclusion of such costs in the rates established in this rate proceeding. In short, this position is completely without merit. The Company will appropriately manage all costs between rate cases and bears the risk of earning a reasonable return. The incentive compensation element of this set of costs is not unique or in any way different from office supplies, information technology costs or base compensation. It is a valid cost that should be included in base rates.

Q. HOW DOES ACHIEVING THE OPERATING INCOME, EARNINGS PER SHARE, AND SHAREHOLDER RETURN METRICS THAT ARE INCLUDED IN INCENTIVE COMPENSATION PLANS BENEFIT THE COMPANY'S CUSTOMERS?

A. Operating income, earnings per share, and shareholder return are ultimately driven by the Company's ability to control its costs, provide safe and reliable service, and operate efficiently and effectively. While these metrics do benefit shareholders, the customers are also benefactors of positive performance by the Company.

Q. PLEASE EXPLAIN.

A. Everything that the Company does impacts both its customers and its shareholders, so the focus of the witnesses of Staff, TIEC, OPUC and COH, as it relates to incentive compensation, is flawed. For example, if the Company hires additional linemen to focus on system reliability, such decisions will, when viewed on a standalone basis, cost the customer more in the form of higher operating expenses and should also improve reliability, but will also reduce the amount of net income available for distribution to shareholders until the point in time when new rates, reflecting the additional cost for the new personnel are approved. That said, the Company's primary focus is appropriately on its customers. This is not an "either/or" issue. If, at the end of the day, the Company does not provide safe, reliable service at a reasonable cost, neither its customers nor shareholders will be satisfied. This highlights precisely why a properly designed incentive compensation plan must include a mixture of goals that lead to success for all interested stakeholders. Therefore, the intervenors' arguments that either customers or shareholders benefit over the other is seriously flawed and misguided. At the end of the day, if the Company provides safe, reliable service at a reasonable cost, which depends upon productive employee behavior, all parties benefit from the Company's actions.

Q. HAVE OTHER COMPANY WITNESSES DISCUSSED THE IMPORTANCE OF THE COMPANY'S ABILITY TO COMPETE IN THE ECONOMIC MARKETPLACE?

A. Yes. Company witnesses McRae and Hevert both discuss the Company's ability to access competitive capital markets to obtain the funds needed to support Company operations. Company witness McRae stated "the ability to attract capital at a reasonable cost in all market conditions is critical for a utility if it is to satisfy its obligation to provide safe and reliable utility service. Financial integrity ensures that the utility will have the flexibility to withstand unanticipated macroeconomic events outside of its control, such as the deep economic downturn that occurred in 2008-2009. In contrast, a lack of financial integrity can limit a utility's ability to finance assets or undertake new projects, particularly during times of capital market volatility. Weak financial integrity also increases the cost of debt and the cost of equity, which in turn increases the overall cost of capital paid by customers."[10]

In his direct testimony, Company witness Hevert added, "To the extent CenterPoint Houston is provided a reasonable opportunity to earn its market-based Cost of Equity, neither customers nor shareholders should be disadvantaged. In

[10] Direct testimony of Company witness McRae, pp. 6-7.

fact, a return that is adequate to attract capital at reasonable terms enables the Company to provide safe, reliable electric utility service while maintaining its financial integrity, all to the benefit of both investors and ratepayers."[11]

Q. DO SIMILAR COMMENTS APPLY TO THE ISSUE OF TOTAL COMPENSATION?

A. Yes. In much the same manner as the need to maintain a strong financial position and have access to market funds at a reasonable rate is important for Company operations, the Company must also be able to offer a competitive total compensation package to its employees and have a reasonable expectation of recovering the costs associated with the required levels of compensation to attract and retain well-qualified employees.

Q. DOES COH WITNESS MR. GARRETT ALSO RELY ON DECISIONS FROM THIS COMMISSION AS WELL AS THOSE IN OTHER STATES TO SUPPORT HIS RECOMMENDATION TO DISALLOW THE COMPANY'S STI AND LTI COSTS THAT, IN HIS VIEW, SOLELY BENEFIT SHAREHOLDERS?

A. Yes, he does.

Q. DID YOU PROVIDE CITATIONS IN YOUR DIRECT TESTIMONY TO COMMISSION DECISIONS THAT ALLOWED BOTH THE RECOVERY OF STI AND LTI EXPENSES?

A. Yes, I did.

[11] Direct testimony of Company witness Hevert, pp. 24-25.

Q. FROM WHICH STATE REGULATORY JURISDICTIONS DID YOU CITE ORDERS THAT ALLOWED THE RECOVERY OF INCENTIVE COMPENSATION COSTS IN RATES?

A. In addition to my citation of this Commission's Order in Docket No. 38339 which allowed the inclusion of incentive compensation costs as a reasonable and necessary component of a total compensation package, I also cited commission orders from Alaska, Colorado, Indiana, Oklahoma and Georgia which also allowed the inclusion of incentive compensation costs to be recovered in rates.

Q. PLEASE BRIEFLY SUMMARIZE SOME OF THE ORDERS THAT YOU CITED IN YOUR DIRECT TESTIMONY.

A. In its Final Order in Cause No. PUD 2018000029, the Oklahoma Commission stated:

> "The principal goal of incentive compensation is employee behavior that promotes safety, operations performance, and financial performance. This behavior is particularly important in years observed in the 2017 test-year where employees must identify and accomplish upgrades to the gas distribution system for safety and reliability and combat customer attrition prevalent in the Company's rural service area, because of factors outside of CenterPoint Oklahoma's control.
>
> Based upon the record before it in this proceeding, the costs for the Company's LTI and STI compensation should be allowed.[12]"

In its Order in Cause No. 43839, the Indiana Utility Regulatory Commission recognized the value of incentive compensation plans as part of an overall compensation package to attract and retain qualified personnel. This Commission recognized that: (1) the incentive plan was not a pure profit-sharing plan, but rather incorporated operational as well as financial performance goals; (2) the plan did

[12] *In the Matter of the Application of CenterPoint Energy Resources Corp.*, Oklahoma Corporation Commission, Order No. 684379, p. 3, Cause No. PUD 2018000029 (2018).

not result in excessive pay levels beyond what is reasonably necessary to attract a talented workforce; and (3) shareholders were allocated part of the cost of the incentive compensation programs.[13] The IURC found that Vectren South's incentive compensation plan did not result in excessive pay levels beyond what was reasonable to attract a talented workforce.[14]

In Docket U-16-066, the Alaska Public Utility Commission found ENSTAR's incentive compensation plans benefit ratepayers by setting and holding employees to goals that directly relate to customer service and cost controls, and by attracting and retaining highly qualified employees to provide safe and reliable service. As a result, that Commission found the incentive compensation amounts to be reasonable.[15]

Q. WERE THE CITED DECISIONS PREMISED UPON A REASONED REVIEW OF THE DETAILS OF EACH COMPANY'S INCENTIVE COMPENSATION PROGRAM?

A. Yes. As opposed to summarily dismissing the incentive costs of the companies' compensation packages which referenced financial goals, each of the cited Commissions (as well as others discussed in my direct testimony) evaluated the reasonableness of the components of each company's incentive compensation package and concluded, based upon that assessment, that the utility's customers did in fact benefit from the entire costs of the compensation package.

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[13] *Petition of Southern Indiana Gas and Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc.*, No. 43839, Final Order, p. 50 (April 27, 2011).
[14] *Petition of Southern Indiana Gas and Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc., for Approval of and Authority for an Increase in Rates*, Indiana Utility Regulatory Commission, Cause No. 43839, Final Order, p. 50, (Apr. 27, 2011).
[15] The Regulatory Commission of Alaska, Order Resolving Revenue Requirement and Cost-of-Service Issues and Requiring Filings, U-16-066 Order 19, pp. 58-59 (Sept. 22, 2017).

Q. ARE YOU SUGGESTING THAT THIS COMMISSION WILL NOT ASSESS THE OVERALL REASONABLENESS OF EACH COMPONENT OF CENTERPOINT HOUSTON'S COMPENSATION PACKAGES IN THIS PROCEEDING?

A. Not at all. My criticism is directed at the testimonies of the Staff and intervenor witnesses in this proceeding who propose adjustments to the Company's total compensation costs solely because some of the goals refer to the financial performance of the Company. None of the witnesses to which I respond in this rebuttal testimony even acknowledge that the Company's compensation package targets the 50th percentile of costs, including incentive compensation payments, of compensation packages of other companies in the Houston area. I find it difficult to believe that this Commission would disallow any compensation costs if the Company's compensation costs were at the 50th percentile of costs in the Houston area but excluded incentive compensation. The Company, however, focuses its employees on goals which clearly benefit its customers in order to receive incentive payments which get the total compensation package to the 50th percentile of market costs, and the Staff and intervenor witnesses find fault in that program.

In my opinion, the Staff and intervenor witness's positions reflect an inaccurate assumption that the Commission always disallows incentive compensation tied to financial metrics, and that all financial metrics benefit shareholders, not customers. Those positions do not represent sound ratemaking policy. The facts in this proceeding should outweigh the incorrectly presumed precedent which the witnesses espouse and turn on the same standards that apply to all expense reviews: are the costs reasonable, and are they necessary for the provision of utility service.

Q. HOW DOES COH WITNESS GARRETT RESPOND TO THE CITATIONS THAT YOU PROVIDED FROM COMMISSION DECISIONS?

A. He dismissively refers to my specific citations as being from "outlier States."[16]

Q. HOW DO YOU RESPOND?

A. Regulatory commissions have to render decisions based upon the information put before them in each proceeding, so it is not unexpected that individual commissions may have varying positions on an issue. Simply because a decision does not support Mr. Garrett's position does not make it an outlier. The decisions stand on their own and were accurately summarized in my direct testimony.

Q. DOES COH WITNESS GARRETT DISPUTE YOUR SUMMARY OF THE COMMISSION'S ORDER IN DOCKET NO. 38339?

A. Yes, he claims that the Company's position is misleading and quotes the Administrative Law Judge's Proposal for Decision.

Q. IS YOUR STATEMENT THAT THIS COMMISSION INCLUDED STI IN THE COMPANY'S LAST ORDER ACCURATE?

A. Yes. As I stated in response to Staff witness Filarowicz's recommended adjustment, the language of this Commission's Final Order does not support either Staff witness Filarowicz's or Mr. Garrett's proposed recommendations. As I previously noted, Finding of Fact 81 in the Order on Rehearing in Docket No. 38339 states, "The evidence demonstrates that CenterPoint's short-term compensation plan (STI) is a reasonable and necessary component of a total

[16] Direct testimony of COH witness Garrett, p. 19, line 27.

compensation package required to recruit, retain, and motivate employees." Finding 83 further states "The corporate and financial goals of STI are directly tied to metrics such as customer service and safety."[17]

Given these affirmative findings from the Order on Rehearing in CenterPoint Houston's last base rate case, COH witness Mr. Garrett is simply incorrect when he states that "CEHE's STI costs were allowed only due to a lack of sufficient evidence presented in that particular docket, not because of a change of the Commission's policy on financially-based incentives."[18]

Q. IS THE FUNDAMENTAL QUESTION REGARDING THE RECOVERY THROUGH RATES OF STI AND LTI EXPENSES WHETHER THE COMPANY'S CUSTOMERS BENEFIT FROM THE GOALS ESTABLISHED IN THOSE PLANS?

A. The threshold issue is whether the costs are reasonable, and whether they are necessary to the provisioning of service. The fact that customers benefit from the goals in CenterPoint Energy's incentive compensation plans provides additional support for the Company's requested cost recovery.

Q. DID YOU EXTENSIVELY ADDRESS THOSE QUESTIONS IN YOUR DIRECT TESTIMONY?

A. Yes, I did.

[17] PUC Docket No. 38339, Order on Rehearing, p. 22, Findings of Fact 81 and 83 (June 23, 2011).
[18] *Id.*, p. 15, lines 8-11.

Q. HOW DID THE WITNESSES THAT ARE ADDRESSING THE TREATMENT OF STI AND LTI COSTS RESPOND TO THAT ASPECT OF YOUR DIRECT TESTIMONY?

A. The witnesses for TIEC and OPUC that address STI and LTI costs did not address the customer benefits of STI and LTI programs that I set forth in my direct testimony, or my conclusion that the costs are reasonable and necessary.

Q. GIVEN YOUR REVIEW OF THE DIRECT TESTIMONIES OF THE STAFF, TIEC, OPUC AND COH WITNESSES ADDRESSING STI AND LTI, HAS YOUR POSITION CHANGED REGARDING THE COMPANY'S PROPOSED INCLUSION IN RATES OF THE STI AND LTI PLAN EXPENSES?

A. No. The testimony of Staff witness Filarowicz, as well as those of the witnesses for the TIEC, OPUC, and COH failed to consider the factors discussed in my direct testimony pertaining to the extremely tight job market that currently exists in the Houston metropolitan area, which makes it difficult to retain and attract qualified employees. The challenges in the Houston job market are exacerbated by the high percentage of employees who currently are, or soon will be, eligible to retire. Further, the witnesses for Staff, TIEC, OPUC and COH failed to address the specific benefits that I set forth in my direct testimony realized from the attainment of goals set forth in the Company's STI and LTI plans.

Q. IN SUPPORT OF HIS ADJUSTMENT DOES STAFF WITNESS FILAROWICZ CITE THE COMMISSION'S DECISION IN DOCKET NO. 33309?

A. Yes, he does.

Q. WHAT LANGUAGE FROM THE COMMISSION'S ORDER DID STAFF WITNESS FILAROWICZ QUOTE?

A. The citation from the Commission's Order in Docket No. 33309 reads as follows:

> TCC's [AEP Texas Central Company, predecessor of AEP] inclusion of annual and long-term incentive compensation related to financial incentives in cost of service is unreasonable because it is not necessary for the provision of T&D [transmission and distribution] utility services.[19]

Q. HOW DO YOU RESPOND TO THE LANGUAGE CITED BY STAFF WITNESS FILAROWICZ FROM A PRIOR COMMISSION ORDER?

A. While such a conclusion could be justified under some conditions, I do not believe that CenterPoint Houston is currently operating under those conditions. As I discussed in my direct testimony, CenterPoint Houston is competing for resources in an environment that is approaching full employment. The need for personnel at the operating level, as well as at the corporate staff level, is approaching critical levels. The Company must provide a compensation package that competes with non-regulated companies for the attraction and retention of talented resources. This is not a question of who benefits from the attainment of operating and financial goals; this is a serious need for qualified employees that maintain levels of system reliability, are responsive to customers' questions and concerns, and that can meet the needed enhancement of the grid to meet customer demand. The dollars in question are not just payments to senior executives, but include operating personnel that directly interact with, and respond to, customers. The Company has to be allowed to offer, and recover via rates, the level of salary and wages required to attract and retain well-qualified personnel required to lead and manage the

[19] Public Utility Commission of Texas, PUC Docket No. 33309, p. 11, Finding of Fact No. 82.

Company, as well as well-trained individuals capable of designing, constructing, operating and maintaining CenterPoint Houston's electric system. The Company will not be able to effectively compete for the scarce resources if it is not able to offer and recover the full cost of competitive wages, and neither Mr. Filarowicz nor any other witness in this case has shown otherwise.

Q. IS THE COMPANY SUGGESTING THAT IT NEEDS TO OFFER EXCESSIVE COMPENSATION LEVELS?

A. No. As I have previously mentioned, the Company's compensation plan is to pay competitive wages (including incentives) that are at the midpoint, or 50th percentile, of the wages offered by other employers in the Houston metropolitan area. Company witness Lynne Harkel-Rumford discusses the benchmarking of the Company's wage levels to that of other companies in her direct testimony.

Q. HAS THE TEXAS LEGISLATURE RECENTLY ADDRESSED THE ISSUE OF WHETHER UTILITY COMPANIES SHOULD BE ALLOWED TO RECOVER THE TOTAL AMOUNT OF INCENTIVE COMPENSATION IN ESTABLISHED RATES?

A. Yes. House Bill 1767 has been passed by both the House and Senate and was signed into law by the Governor on June 15, 2019. The legislation states, in part,

> "When establishing a gas utility's rates, the regulatory authority shall presume that employee compensation and benefits expenses are reasonable and necessary if the expenses are consistent with market compensation studies issued not earlier than three years before the initiation of the proceeding to establish the rates."[20]

While the legislation pertains to gas utilities, it would presumably be good regulatory policy to treat gas and electric companies similarly when establishing

[20] Texas General Assembly, House Bill 1767, as enrolled (effective June 15, 2019).

rates so as to not provide an undue advantage or benefit to one utility over another. This is particularly true for an entity such as CenterPoint Energy, which operates both gas and electric utilities. Ms. Harkel-Rumford addresses in her rebuttal testimony the extent to which certain affiliate employees provide services to the gas and electric utilities because there are compensation costs the Company requests to recover in this case that are related to those types of employees. If this were a gas utility case, those costs would be presumed reasonable. Where both gas and electric utilities are offered the same compensation package with incentive plans that are based on market compensation studies, there is no regulatory or ratemaking justification for treating compensation and benefit cost recovery for electric service different from gas service. Furthermore, the legislation highlights the appropriateness of the Company's use of market compensation studies to determine employee compensation.

Q. HAVE YOU INCLUDED AN AS AN EXHIBIT TO YOUR TESTIMONY THE LANGUAGE OF HOUSE BILL 1767?

A. Yes. An enrolled version of the bill is provided as Exhibit R-JJR-1.

Q. WHAT ARE YOUR OBSERVATIONS AND COMMENTS PERTAINING TO THE NEWLY SIGNED LEGISLATION?

A. I view the legislation as a triggering event suggesting that the Commission fully evaluate the way in which it treats total compensation in rate proceedings. As stated in the new law, the standard should be whether the compensation expense is reasonable and necessary. Furthermore, where the compensation levels are consistent with recent benchmark studies, there should be a presumption that these costs meet that standard. In other words, although the Commission may have ruled the way it did regarding incentive compensation in the past SWEPCO and SPS cases, since that time the state legislature has spoken regarding whether similar expenses (for gas utilities) should be presumed to be reasonable and necessary if such costs are consistent with the marketplace. By way of his signing of the legislation into law, the Governor concurred.

Q. WOULD THE TREATMENT AFFORDED BY THIS COMMISSION IN DOCKET NO. 38339, AS IT RELATES TO THE RECOVERY OF COMPENSATION COSTS, BE CONSISTENT WITH THE INTENT OF THE PROPOSED LEGISLATION?

A. In part. While the Commission allowed recovery of the Company's STI costs in that docket, the Commission disallowed the Company's recovery of LTI costs. The new legislation for gas utilities creates a presumption that employee compensation costs[21] shown to be consistent with market compensation studies, including both STI and LTI, are to be deemed reasonable and necessary.

III. RECOMMENDATION

Q. WHAT IS YOUR RECOMMENDATION IN THIS PROCEEDING?

A. My recommendation is unchanged from my direct testimony. It is my recommendation that the Commission allow CenterPoint Houston to include its full compensation costs paid to its employees, including incentive compensation, in rates that are established in this proceeding. My recommendation is premised upon the following facts:

- The recent passage and signing into law House Bill 1767 provides important legislative guidance as to the proper evaluation and regulatory treatment of compensation expenses and should provide the Commission a roadmap to

[21] The bill excludes the incentive compensation related to financial metrics of certain senior executives.

facilitate its decision-making as to whether compensation and benefits expenses are reasonable and necessary.

- CNP's total compensation costs, including incentive costs, are reasonable and approximate the median (50th percentile) of the market for total compensation represented by the companies included in the market surveys CNP uses to assess the competitiveness of its compensation and benefits.

- The compensation package offered by CNP and the Company is reasonable and required to recruit, retain, and motivate employees in a highly competitive job market.

- CNP's incentive goals are directly tied to metrics such as cost management, customer service and safety.

- The disallowance of incentive compensation expenses could produce unintended consequences that decrease the level of service provided to CenterPoint Houston's customers (via less qualified and/or motivated employees), while increasing the total cost of services provided via lower productivity.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

STATE OF Massachusetts §
§
COUNTY OF Middlesex §

AFFIDAVIT OF John J. Reed

BEFORE ME, the undersigned authority, on this day personally appeared John J. Reed who having been placed under oath by me did depose as follows:

1. "My name is John J. Reed. I am of sound mind and capable of making this affidavit. The facts stated herein are true and correct based upon my personal knowledge.

2. I have prepared the foregoing Direct Testimony and the information contained in this document is true and correct to the best of my knowledge."

Further affiant sayeth not.

John J. Reed

SUBSCRIBED AND SWORN TO BEFORE ME on this 18 day of June, 2019.

Notary Public in and for the State of MA

My commission expires: April 22, 2022

WENDY L. PRESTON
Notary Public
COMMONWEALTH OF MASSACHUSETTS
My Commission Expires
April 22, 2022

H.B. No. 1767

AN ACT

relating to the consideration of employee compensation and benefits in establishing the rates of gas utilities.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

SECTION 1. Subchapter B, Chapter 104, Utilities Code, is amended by adding Section 104.060 to read as follows:

Sec. 104.060. CONSIDERATION OF COMPENSATION AND BENEFIT EXPENSES. (a) In this section, "employee compensation and benefits" includes base salaries, wages, incentive compensation, and benefits. The term does not include:

(1) pension or other postemployment benefits; and

(2) incentive compensation related to attaining financial metrics for an executive officer whose compensation is required to be disclosed under 17 C.F.R. Section 229.402(a).

(b) When establishing a gas utility's rates, the regulatory authority shall presume that employee compensation and benefits expenses are reasonable and necessary if the expenses are consistent with market compensation studies issued not earlier than three years before the initiation of the proceeding to establish the rates.

SECTION 2. (a) Section 104.060, Utilities Code, as added by this Act, applies only to a proceeding for the establishment of rates for which the regulatory authority has not issued a final order or decision before the effective date of this Act.

(b) A proceeding for which the regulatory authority has issued a final order or decision before the effective date of this Act is governed by the law in effect immediately before that date, and that law is continued in effect for that purpose.

SECTION 3. This Act takes effect immediately if it receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If this Act does not receive the vote necessary for immediate effect, this Act takes effect September 1, 2019.

H.B. No. 1767

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President of the Senate Speaker of the House

I certify that H.B. No. 1767 was passed by the House on April 15, 2019, by the following vote: Yeas 103, Nays 38, 2 present, not voting; and that the House concurred in Senate amendments to H.B. No. 1767 on May 22, 2019, by the following vote: Yeas 138, Nays 6, 1 present, not voting.

____

Chief Clerk of the House

I certify that H.B. No. 1767 was passed by the Senate, with amendments, on May 14, 2019, by the following vote: Yeas 30, Nays 1.

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Secretary of the Senate

APPROVED: ____________________

Date

____

Governor