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APPLICATION OF

AEP TEXAS INC.

FOR AUTHORITY TO CHANGE RATES

REBUTTAL TESTIMONY OF

JUDITH E. TALAVERA

FOR

AEP TEXAS INC.

AUGUST 2019

392

TESTIMONY INDEX

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1 I. INTRODUCTION

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is Judith E. Talavera. My business address is 539 N. Carancahua, Corpus
4 Christi, Texas 78401.

5 Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

6 A. I am President and Chief Operating Officer of AEP Texas Inc. (AEP Texas or the
7 Company). AEP Texas is a transmission & distribution (T&D) utility and a wholly
8 owned subsidiary of American Electric Power Company, Inc. (AEP). AEP Texas
9 operates exclusively within the borders of the Electric Reliability Council of Texas
10 (ERCOT).

11 Q. ARE YOU THE SAME JUDITH TALAVERA THAT FILED DIRECT TESTIMONY
12 IN THIS PROCEEDING?

13 A. Yes.
14

15 II. PURPOSE OF TESTIMONY

16 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

17 A. The purpose of my rebuttal testimony is to address the Staff of the Public utility
18 Commission of Texas' (PUC or Commission) policy as it relates to recovery of
19 incentive compensation paid to the Company's employees. The evidence in this case
20 establishes that the Company's total compensation package, which includes incentive
21 compensation, is market competitive and an appropriate element of AEP Texas'
22 reasonable and necessary operating costs incurred to provide service to customers.
23 Nonetheless, various parties ask the Commission to deny AEP Texas recovery of

1 certain costs, both labor costs and invested capital, associated with incentive
2 compensation. These parties include the Commission, Cities Served by AEP Texas
3 (Cities), Office of Public Utility Counsel (OPUC), and Federal Executive Agencies
4 (FEA). My rebuttal testimony identifies good cause for the Commission to reconsider
5 its policy as it relates to the recovery of incentive compensation. Further, to the extent
6 that the Commission does not elect to reconsider its policy, my rebuttal testimony
7 addresses the evolving nature of the Commission's policy and how that evolving policy
8 should be applied to the capital that AEP Texas has prudently invested on behalf of
9 customers.
10

11 III. INCENTIVE COMPENSATION

12 A. The Commission's Incentive Compensation Recovery Policy

13 Q. CITIES, OPUC, FEA, AND COMMISSION STAFF RECOMMEND VARYING
14 DISALLOWANCES OF THE INCENTIVE COMPENSATION PAID TO AEP
15 TEXAS EMPLOYEES, BOTH DURING THE TEST YEAR AND OVER THE
16 MORE THAN TWELVE YEARS SINCE THE CLOSE OF THE COMPANY'S
17 PREVIOUS BASE RATE TEST YEAR. WAS AEP TEXAS AWARE OF THE
18 COMMISSION PRECEDENT CITED BY THESE PARTIES AS THE BASIS FOR
19 THEIR RECOMMENDATIONS?

20 A. Yes. As I noted in my direct testimony, AEP Texas is aware of the Commission's
21 policy. AEP Texas is also aware of the evolving nature of that policy and the way the
22 Commission has implemented that policy in utility base rate cases over time and, in
23 particular, in recent years. However, the Company believes that developments at the

1 Texas Legislature provide the Commission with an opportunity and a basis to
2 reconsider that policy.

3 Q. WHY DO YOU USE THE WORD “POLICY” IN THIS CONTEXT?

4 A. It is my understanding that nothing in PURA requires the disallowance of any portion
5 of compensation paid to the Company’s employees as long as that compensation is
6 reasonable and necessary. PURA states that the Commission is to set rates that will
7 allow the utility an opportunity to earn a reasonable return on its invested capital “in
8 excess of the utility’s reasonable and necessary operating expenses.” The utility’s
9 operating expenses include compensation paid to employees.

10 Q. IS THE AMOUNT OF COMPENSATION THAT THE COMPANY PAYS ITS
11 EMPLOYEES REASONABLE AND NECESSARY?

12 A. Yes. The direct testimony of AEP Texas witness Andrew Carlin in this proceeding
13 establishes that the Company provides a total compensation package that is at the
14 median of the total compensation packages provided for similar positions in the labor
15 market from which the Company needs to attract and retain employees. In addition,
16 Mr. Carlin’s testimony establishes that the Company’s incentive compensation paid at
17 a “1.0” target level (which is all that AEP Texas is requesting) is a necessary element
18 to achieve that market-competitive pay for employees. The Company’s incentive
19 compensation program is not a “bonus” on top of market-competitive pay.

20 Q. DID MR. CARLIN FILE SIMILAR TESTIMONY IN SOUTHWESTERN
21 ELECTRIC POWER COMPANY (SWEPCO) DOCKET NOS. 40443 AND 46449?

22 A. Yes.

1 Q. WHY THEN SHOULD THE COMMISSION RECONSIDER ITS POLICY WITH
2 REGARD TO INCENTIVE COMPENSATION?

3 A. First and foremost, the Commission should reconsider its policy because the Company
4 has designed its total compensation package, including the incentive compensation
5 portion, to be market-competitive and to attract and retain the employees necessary to
6 provide customers with reliable service. Allowing full recovery of these legitimately
7 incurred costs enables AEP Texas to continue to provide reliable service to its
8 customers. Further, there has been activity at the Texas Legislature that provides the
9 Commission with the opportunity and a basis on which to reconsider its previous
10 policy.

11 Q. PLEASE EXPLAIN FURTHER.

12 A. In the recently concluded legislative session, the Legislature passed and the Governor
13 signed into law a statute applicable to natural gas utilities operating in Texas governing
14 the recovery of compensation paid to the utility's employees. In relevant part, the
15 newly enacted statute states:

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

21 Q. WHY IS THIS STATUTE RELEVANT TO THE COMMISSION'S CURRENT
22 POLICY REGARDING THE RECOVERY OF INCENTIVE COMPENSATION?

23 A. The newly enacted statute expressly recognizes that "employee compensation"
24 includes not only base salaries and wages but also incentive compensation. If the utility
25 has shown that total compensation to be consistent with market compensation studies,

1 as AEP Texas has in this case, the regulatory authority is to afford that compensation a
2 presumption of reasonableness when setting rates.

3 Q. DOES THE ABOVE-QUOTED STATUTE BIND THE COMMISSION IN THIS
4 CASE?

5 A. No. This statute is applicable only to natural gas utilities, which are regulated by the
6 Railroad Commission of Texas. However, the newly enacted statute demonstrates the
7 Legislature's view that the recoverability of utility employee compensation should be
8 judged by its consistency with market compensation studies.

9 Q. WAS THERE A SIMILAR BILL FILED DURING THE MOST RECENT
10 LEGISLATIVE SESSION THAT WOULD HAVE BEEN APPLICABLE TO
11 ELECTRIC UTILITIES?

12 A. Yes. However, the Legislature took no action on that bill. In other words, neither the
13 Legislature nor any committee thereof took a vote on that bill.

14 Q. CAN YOU DRAW ANY CONCLUSIONS REGARDING WHETHER THE
15 LEGISLATURE WILL PASS SUCH A BILL APPLICABLE TO ELECTRIC
16 UTILITIES IN THE FUTURE?

17 A. No, I cannot. The fact is some bills on which the Legislature takes no action are again
18 introduced and passed in a later legislative session and some are not. However, I know
19 of no distinction between the gas utility industry and electric utility industry that would
20 justify a difference in cost recovery in this instance.

1 B. Application of the Commission's Evolving Policy to Invested Capital

2 Q. ABOVE, YOU REFER TO THE EVOLVING NATURE OF THE COMMISSION'S
3 POLICY REGARDING THE RECOVERY OF INCENTIVE COMPENSATION
4 PAID TO EMPLOYEES. WILL YOU PLEASE EXPLAIN?

5 A. Yes. I note that the testimony of Staff witness Ms. Givens refers to and recounts what
6 she alleges to be the "longstanding Commission precedent" regarding the recovery of
7 incentive compensation. The testimonies of OPUC witness Ms. Cannady, Cities
8 witness Mr. Kollen, and FEA witness Mr. Smith also refer to this precedent in varying
9 degrees. However, none of the testimonies explain the evolving nature of the
10 Commission's policy and how its application to the expenses and invested capital of
11 utilities has changed over time.

12 Q. IN AEP TEXAS' MOST RECENT BASE RATE CASE, DID THE COMMISSION
13 DISALLOW RECOVERY OF A PORTION OF AEP TEXAS' INCENTIVE
14 COMPENSATION EXPENSE?

15 A. Yes. In Docket No. 33309, the Commission disallowed from the Company's labor
16 expense those amounts of incentive compensation tied to meeting financial goals.
17 However, the Commission made no adjustment to the Company's invested capital
18 associated with incentive compensation.

19 Q. WHEN DID THE COMMISSION FIRST MAKE AN ADJUSTMENT TO A
20 UTILITY'S INVESTED CAPITAL ASSOCIATED WITH INCENTIVE
21 COMPENSATION?

22 A. That did not occur until much later. In Docket No. 39896, a base rate proceeding for
23 Entergy Texas, Inc., the Commission changed its application of this policy. In that

1 case, the Commission identified amounts of incentive compensation that had been
2 capitalized (*e.g.*, labor associated with capital projects, such as distribution and
3 transmission lines and other utility assets) and removed from rate base a value
4 associated with incentive compensation triggered by meeting financial goals. The date
5 of the Order on Rehearing in Docket No. 39896 is November 2, 2012.

6 Q. HAS THERE BEEN ANOTHER SIGNIFICANT EVOLUTION IN THE
7 COMMISSION'S POLICY SINCE AEP TEXAS' PREVIOUS RATE CASE,
8 DOCKET NO. 33309?

9 A. Yes. In Docket No. 40443, the Proposal for Decision described the Commission's
10 then-existing policy:

11 The PUC permits a utility to recover in its base rate incentives that are
12 designed to achieve "operational measures" and that are necessary and
13 reasonable to provide utility services, but not incentive programs that
14 are designed to achieve "financial measures." (PFD at 79.)

15 As discussed by AEP Texas witness Mr. Carlin, pay-outs of incentive compensation
16 are triggered by meeting certain goals, some of which the Commission considers to be
17 operational and some of which the Commission considers to be financial. In other
18 words, the recoverability of incentive compensation hinged on whether goals that
19 triggered pay-outs were operational or financial. However, in Commission Docket No.
20 43695 the Commission significantly altered this policy.

21 Q. PLEASE EXPLAIN.

22 A. Docket No. 43695 was a base rate proceeding for Southwestern Public Service
23 Company (SPS). In that proceeding, the Commission disallowed recovery of incentive
24 compensation triggered by meeting financial goals. However, in addition to this

1 amount, the Commission disallowed a significant additional amount of SPS's incentive
2 compensation because SPS had an incentive compensation *funding mechanism* that
3 included earnings per share. In other words, only if the utility has sufficient earnings,
4 would there be money funded into the incentive compensation program that employees
5 would then earn by meeting their set operational and financial goals. The Order on
6 Rehearing in Docket No. 43695 was issued on February 23, 2016.

7 Q. WAS THIS ALTERATION OF COMMISSION POLICY APPLIED IN DOCKET
8 NO. 46449, A SWEPCO BASE RATE PROCEEDING?

9 A. Yes. The Proposal for Decision issued in that case provides a succinct description of
10 that altered policy:

11 Staff acknowledges that SWEPCO did remove some of the financially-
12 based performances measures from its requested cost of service.
13 However, based on the precedent set in SPS Docket No. 43695, not only
14 should the specific measures based on financial metrics be disallowed,
15 but a portion of the entire compensation plan should also be disallowed
16 due to a financially-based earnings trigger that must be met before any
17 incentives were earned. In SPS Docket No. 43695, SPS's compensation
18 plan recovered in rates was reduced by 50% due to this financially-based
19 earnings trigger, and Staff maintains the same result should apply here
20 as well. (PFD at 240-41.)

21 Q. WHY IS THIS EVOLUTION IN THE COMMISSION'S POLICY RELEVANT IN
22 THIS PROCEEDING?

23 A. Both Staff and OPUC allege that application of the Commission's policy now requires
24 the disallowance of very significant amounts of the Company's invested capital dating
25 back to July 2006. As I explain above, there is good cause for the Commission to
26 reconsider and change its policy. However, this section of my testimony assumes that
27 the Commission does not choose to change that policy. If the Commission chooses not

1 to make a policy change at this time, AEP Texas still takes issue with the way that Staff
2 witness Ms. Givens and OPUC witness Ms. Cannady apply that evolving policy to the
3 Company's capital prudently invested since July 2006.

4 Q. PLEASE EXPLAIN.

5 A. Both Ms. Givens and Ms. Cannady recommend disallowances of the Company's
6 capital prudently invested since July 2006 even though the Commission did not begin
7 to disallow capital associated with financially based incentive compensation until
8 Docket No. 39896. No utility in the State of Texas had any of its prudently invested
9 capital disallowed on this basis until Docket No. 39896, where the final order was
10 issued November of 2012. Yet, both Ms. Givens and Ms. Cannady recommend that
11 application of Commission policy adopted in Docket No. 39896 be retroactively
12 applied back to 2006 for AEP Texas – more than six years before that change took
13 place. If the Commission chooses to implement its current policy of disallowing
14 invested capital associated with financially triggered incentive compensation, it should
15 do so only back to the final order that established that application of Commission policy
16 in November of 2012.

17 Q. ARE THE RECOMMENDATIONS OF MS. GIVENS AND MS. CANNADY
18 FURTHER INCONSISTENT WITH THE EVOLVING NATURE OF THE
19 COMMISSION'S POLICY?

20 A. Yes. As noted above, it was not until Docket No. 43695 that the Commission began
21 disallowing a portion of incentive compensation simply because of the funding
22 mechanism for the incentive compensation plan. Despite this fact, Ms. Givens and Ms.
23 Cannady both recommend retroactive application of that policy back to July 2006. If

1 the Commission chooses to disallow AEP Texas invested capital associated with the
2 incentive compensation funding mechanism, it should do so only back to February
3 2016, when the final order in Docket No. 43695 was issued.

4 Q. ASSUMING THAT THE COMMISSION INTENDS TO DISALLOW AEP TEXAS
5 INVESTED CAPITAL ASSOCIATED WITH FINANCIALLY TRIGGERED
6 INCENTIVE COMPENSATION, HAS ANOTHER AEP TEXAS WITNESS
7 CORRECTLY CALCULATED SUCH A DISALLOWANCE BASED ON THE
8 ABOVE CONSIDERATIONS?

9 A. Yes. That calculation is addressed by AEP Texas witness Mr. Hamlett.

10 Q. ARE THERE ANY FINAL FACTS THE COMMISSION SHOULD CONSIDER
11 REGARDING THIS ISSUE?

12 A. Yes. Even if the Commission were to choose not to change its current policy regarding
13 recovery of incentive compensation, Staff witness Ms. Givens' and Cities witness Mr.
14 Kollen's recommendations do not accurately reflect that policy. This error is addressed
15 in the rebuttal testimony of AEP Texas witness Mr. Hamlett.

16

17 IV. CONCLUSION

18 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

19 A. Yes, it does.