

DIRECT TESTIMONY - PAUL F. MECHAM

1 **Q. Please state your name and business affiliation.**

2 **A.** My name is Paul F. Mecham. I am employed by the Utah Division of Public Utilities
3 (Division) as a Management Analyst.

4 **Q. What are your current responsibilities?**

5 **A.** My responsibilities include: preparing analyses and researching issues on utility
6 functional areas to determine the potential benefits to companies and ratepayers;
7 coordinating and monitoring consultants' analysis work; monitoring utility customer
8 complaints and monitoring utility compliance with state laws and Public Service
9 Commission (Commission) rules, regulations and orders.

10 **Q. What are your qualifications for providing this testimony?**

11 **A.** I have been employed in the Division for over 15 years, during which time I have
12 prepared testimony in dockets involving all three major Utah utilities. For 16 years,
13 before joining the Division, I worked at a management level in companies varying in size
14 from about 400 employees to over 8,000 employees. My duties varied in administration
15 but in each case included responsibilities for personnel management. I have a masters
16 degree in management.

17 **Q. What is the purpose of your testimony in this case?**

18 **A.** I address the costs of PacifiCorp's incentive compensation plans.

19 **Q. Have you prepared exhibits to support your testimony?**

20 **A.** Yes. I have prepared Exhibit DPU 5.1 which summarizes the amount of my
21 recommended adjustment and Exhibit 5.2 which shows the calculations in determining
22 the recommended adjustment.

1 **Q. Did the Company submit testimony in this case describing its incentive plans other**
2 **than Long Term Incentive Plan (LTIP) in ways that demonstrated their compliance**
3 **with earlier Commission orders?**

4 **A.** No, it did not.

5 **Q. Does PacifiCorp currently use, or did it use during the test year, incentive plans that**
6 **have been reviewed previously by this Commission?**

7 **A.** No. Their plans are new. In PacifiCorp's response to DPU Data Request 8.12, they
8 stated:

9 The prior annual incentive programs have been suspended for 1999 due to
10 business restructuring and transformation. This program will replace the prior
11 programs for the calendar year of 1999.

12 **Q. Did PacifiCorp indicate in its testimony/application that the criteria for awarding**
13 **incentive compensation had changed from the program reviewed and approved by**
14 **the Commission in the past?**

15 **A.** No.

16 **Q. What incentive compensation programs does PacifiCorp currently use?**

17 **A.** PacifiCorp's response to DPU Data Request 8.11 listed three programs. They are:

- 18 1. Wholesale Sales and Energy Trading Special Sales Incentive Program (WES).
19 2. Executive Incentive Program and
20 3. PerformanceShare Program,

21 **Q. Please summarize, in outline form, PacifiCorp's incentive programs.**

1 **A. Summary of PacifiCorp's Incentive Compensation Programs**

2 **WHOLESALE ENERGY SERVICES (WES)**

3 Applies to selected WES employees

4 Essentially a marketing/trading commission program

5 **EXECUTIVE INCENTIVE PROGRAM**

6 Applies to Executive Officers

7 Based on Financial performance and profitability goals (Purely Financial)

8 **PERFORMANCE SHARE PROGRAM**

9 Applies to all employees except Executives and WES

10 Has two parts, Group Performance Award and Corporate Performance Award

11 Corporate Performance Award

12 Based on Earnings per share (Purely Financial)

13 Group Performance Award

14 ½ based upon company profits (Purely Financial, Triggered by company profits)

15 ½ prefunded in budget (Some Ratepayer benefit appears likely.)

16 **Wholesale Energy Services (WES)**

17 **Q. Do you intend to recommend an adjustment to WES?**

18 **A.** No.

19 **Executive Incentive Program**

20 **Q. What PacifiCorp employees are eligible for the Executive Incentive Program?**

21 **A.** All PacifiCorp executive officers are eligible participants.¹

22 **Q. What is the Purpose of the Executive Incentive Program?**

23 **A.** In PacifiCorp's response to DPU Data Request 8.12, it stated:

¹PacifiCorp handout on the Executive Incentive Program, page 1

1 The purpose of the Executive Incentive Program is to provide a means for
2 rewarding officers for their success in improving customer service, operational
3 effectiveness and shareholder value.

4 **Q. What are the performance goals of the Executive Incentive Program?**

5 **A. In PacifiCorp's response to DPU Data Request 8.12, it stated:**

6 Participants will have all or part of their incentive award determined based upon
7 PacifiCorp's Financial performance. Some participants may have their incentive
8 award partially determined based upon Business Unit performance against
9 profitability goals.

10 **Q. What were the Business Unit goals?**

11 **A. In PacifiCorp's response to DPU Data Request 8.12, it stated that Exhibit C for the plan**
12 year describes the approved Business Unit goals and measures for the current plan year.
13 Exhibit C showed:

14 No Business Unit Goals for 1999

15 **Q. Did you find the topics or words, "customer service, operational effectiveness"**
16 **anywhere other than in the introductory paragraph on the purpose of the Executive**
17 **Incentive Plan?**

18 **A. No.**

19 **Q. What conclusion do you draw from this information?**

20 **A. The Executive Incentive Plan is purely financial with no demonstrated ratepayer benefit.**

21 **Q. How much of the costs of the Executive Incentive Plan do you recommend be**
22 **allowed as expenses in computing revenue requirement?**

23 **A. Zero. I recommend an adjustment to PacifiCorp's revenue requirement for the total**
24 amount of the Executive Incentive Plan costs.²

²No cost breakdown for incentive compensation was contained in PacifiCorp's filing. Nor was an adequate response received to an earlier DPU data request. At the time the writing of this

1

PerformanceShare Program

2 **Q. What PacifiCorp employees are eligible for the PerformanceShare Program?**

3 **A.** All regular, full- and part-time employees, provided they were not eligible for another
4 incentive program (such as the WES incentive program). PacifiCorp executive officers
5 are not eligible to participate in this program.³

6 **Q. What is the Purpose of the PerformanceShare Program?**

7 **A.** In PacifiCorp's response to DPU Data Request 8.12, it stated:

8 The purpose of the Special PerformanceShare Program for 1999 is to motivate
9 and reward employees for (1) contributions to operational effectiveness and
10 outstanding customer service provided by the group in which they work; and (2)
11 achieving high levels of profitability for PacifiCorp's stakeholders.

12 **Q. What are the two components of the PerformanceShare Program?**

13 **A.** Corporate Performance Award.⁴ and
14 Group Performance Award⁵

15 **Q. Upon what is the Corporate Performance Award portion of the PerformanceShare
16 Program based?**

17 **A.** PacifiCorp's response to DPU Data Request 8.12, stated:

18 The Corporate Performance Award, which is funded from PacifiCorp's profit, is
19 designed to focus employees on achieving high levels of Earnings per Share
20 performance for PacifiCorp so that all participants can share in the success of the
21 Company.

testimony, a data request is pending requesting further clarification.

³PacifiCorp handout on the Special PerformanceShare Program for 1999, page 1

⁴PacifiCorp handout on the Special PerformanceShare Program for 1999, page 4

⁵PacifiCorp handout on the Special PerformanceShare Program for 1999, page 2

1 **Q. What conclusion do you draw from that?**

2 **A.** The Commission has previously concluded that earnings per share is a goal which
3 benefits only shareholders, not ratepayers. On page 48 of the Report and Order in Docket
4 No. 93-057-01, the Commission stated:

5 Our policy has been to disallow recovery of expenses associated with financial
6 goals where no credible link to ratepayer benefit is established.

7 **Q. Are there links to ratepayer benefit in the Corporate Performance Award?**

8 **A.** No. It is purely based upon attaining financial goals.

9 **Q. How much of Corporate Performance Award costs do you recommend allowing?**

10 **A.** Zero. I recommend removing the total cost from the Company's revenue requirement.

11 **Q. Upon what is the Group Performance Award portion of the PerformanceShare
12 Program based?**

13 **A.** PacifiCorp's response to DPU Data Request 8.12, stated:

14 The Group Performance Award, one-half of which is pre-funded in the budget, is
15 designed to focus employees on meeting and exceeding the annual goals
16 established for the work group. The remaining half of the earned award is
17 unbudgeted, and funding for this portion of the payment is dependent upon
18 company profits. . . .

19 **Q. What conclusion do you draw from that?**

20 **A.** The half that depends upon company profits should be disallowed and an adjustment
21 made by the Commission in determining revenue requirement in this rate case.

22 **Q. Upon what do you base this conclusion?**

23 **A.** This part of the program violates three Commission-adopted tenets. They are: The
24 requirement for ratepayer benefit, the exclusion of purely financial goals and the non-use
25 of an income trigger. On page 54 of the Report and Order in Docket No. 93-057-01

1 regarding recognition of incentive compensation for revenue requirement, the

2 Commission stated:

3 To summarize, our policy has been to allow recovery of expenses if ratepayer
4 benefit is demonstrated, and is not merely conjectural. We reaffirm this policy
5 here and disallow expenses for financial goals and the net income trigger. We
6 also eliminate the expenses of the load-building sales goal, because net ratepayer
7 benefit has not been shown.

8 **Q. What about the half of the Group Performance Award that is pre-funded?**

9 **A.** To its credit, it has an Individual Performance Modifier which appears to match the
10 Commission's tenet of being tied to individual performance. It also refers to "customer
11 service" in several places in the published plan.

12 **Q. Were you able to tie "customer service" to specific goals that had demonstrated
13 ratepayer benefit?**

14 **A.** Partially. I submitted the following data request to PacifiCorp:

15 DPU Data Request 8.14: Separately for each plan, please list the following
16 (include information on all items, whether or not plan costs were incurred and
17 paid in the test year):

- 18 a. Each target or goal upon which at-risk compensation is based.
- 19 b. The actual performance level reached relative to each goal.
- 20 c. The calculations used to convert goal and applicable performance
21 to dollars. . . ."

22 PacifiCorp provided approximately 223 proprietary pages of data in response to this
23 request. They contain many items which translate into customer service and reaching
24 those goals probably results in ratepayer benefits, particularly in areas like the Business
25 Center and Customer & Community Svc. However, some of the goals such as
26 shareholder services, have no demonstrable ratepayer benefit. The data response did not
27 demonstrate ratepayer benefit from attaining goals. The Company just provided copies of
28 documents which apparently were used in the internal administration of the programs and
29 were not designed for use in a rate case. In spite of these shortcomings, I feel there are
30 goals within the programs which, indeed, can motivate employees to actions which have
31 ratepayer benefits.

1 **Q. Do you recommend allowing part of the Group Performance Award in computing**
2 **revenue requirement?**

3 **A.** Yes, the half which was budgeted and was not dependent upon company profits. From the
4 data provided by the Company, I found it impossible to calculate the portion or
5 percentage of goals that had ratepayer benefits. For the purposes of this prefiled direct
6 testimony, I have given the company the full benefit of the doubt and recommended
7 allowing all of this budgeted half. The primary reason for this recommendation is to send
8 the signal to the company to encourage its employees to work to achieve goals which
9 benefit ratepayers as well as the shareholders.

10 **Q. Can you quantify the amount of the recommended disallowance?**

11 **A.** Not with precision. I have attached Exhibit DPU 5.2 which I have titled
12 “PerformanceShare Approximations.” This exhibit extracts amounts from Company data
13 responses 8.14 which purportedly shows total incentive compensation costs. One critical
14 part of the Company’s data response is labeled “PerformanceShare” but I believe the data
15 to be total. I have excluded the capital portions and considered only the expense portions.

16 **Q. Is this a “final” number?**

17 **A.** Certainly not. It needs to be refined based upon Company responses to pending follow-up
18 data requests.

19 **Q. Considering the Group Performance Award component of the PerformanceShare**
20 **Program alone, what adjustment do you recommend to expenses in computing**
21 **revenue requirement?**

22 **A.** I recommend a reduction in PacifiCorp’s revenue requirement of \$5,014,810.⁶

⁶No cost breakdown for incentive compensation was contained in PacifiCorp’s filing. Nor was an adequate response received to an earlier DPU data request. At the time the writing of this testimony, a data request is pending requesting further clarification.

1

Adjustment Summary

2 **Q. Please summarize your recommended adjustments.**

3 **A.** Executive Incentive Program

4 PerformanceShare Program (Corporate Performance Award)

5 (The above two combined) \$6,588,537

6 PerformanceShare Program (Group Performance Award) \$5,014,810

7 TOTAL ADJUSTMENT: \$11,603,347⁷

8

General

9 **Q. Is it the Division's position that PacifiCorp should not use incentive compensation?**

10 **A.** No. Company management has the prerogative to try to motivate its employees using
11 incentive compensation if it so chooses.

12 **Q. What, then, is the issue?**

13 **A.** The issue is who should fund the programs, ratepayers or shareholders. In addition to
14 Commission orders quoted earlier, the three following quotes over a period of years shed
15 additional light on the Commission's position.

16 Docket No. 93-057-01, starting on page 48: Our policy has been to disallow
17 recovery of expenses associated with financial goals where no credible link to
18 ratepayer benefit is established. There is no apparent disagreement with this
19 policy. Witnesses have quoted it in testimony and have agreed that the plan should
20 benefit both ratepayers and shareholders. Therefore, the question is whether
21 Mountain Bell has established this link. We agree with the Division and the
22 Committee that it has not done so. The record contains subjective assertion, not
23 quantitative demonstration. We have consistently rejected this and will do so
24 again here. We find that incentive compensation expense associated with the
25 attainment of purely financial goals should not be recovered in rates.

⁷No cost breakdown for incentive compensation was contained in PacifiCorp's filing. Nor was an adequate response received to an earlier DPU data request. At the time the writing of this testimony, a data request is pending requesting further clarification.

1 Docket No. 95-049-05, page 24: The Commission has previously heard and
2 rejected the argument from PacifiCorp and Mountain Fuel, as well as USWC, that
3 increased income arising from incentive compensation reduces revenue
4 requirement. Since financial goals can be achieved at the expense of customer
5 service, the Commission reiterates its policy that an acceptable incentive
6 compensation plan, to be recoverable in rates, must have as its primary objective
7 customer service goals, not financial goals.

8 Docket No. 97-035-01, page 12: If the expenses of an incentive plan are to
9 recovered in rates, the plan's primary goal must be enhancement of customer
10 service.

11 **Q. The amounts in your recommended adjustments do not appear precise. Why is**
12 **that?**

13 **A.** Incentive compensation was not separately addressed in PacifiCorp's filing. The
14 following shows DPU Request 8.14 along with PacifiCorp's response:

15 Request: Separately for each plan, please list the following (include information
16 on all items, whether or not plan costs were incurred and paid in the test year):

17 . . .

18 e. The location (page #, line #, etc.) in PacifiCorp's rate-case filing of
19 plan costs

20 Response: The costs of the plans are included in unadjusted results in Tab 2 of the
21 filing. The accounts and the Total Company amount and Utah portions are listed
22 on Attachment DPU 8.14(e).

23 The total amount in this testimony come from the Company's attachment (d) to the
24 Response which differed from that in their attachment (e) by over \$18,000 (total
25 company). The amounts were not identifiable in "Tab 2 of the filing." At the time of the
26 writing of this testimony, a data request is pending requesting further clarification.

27 **Q. The company removed the costs for its long-term executive incentive compensation**
28 **plan (LTIP) in its Adjustment 4.4 of its application. Do you support this**
29 **adjustment?**

30 **A.** Yes. That adjustment is being made for the very same reasons mentioned in this
31 testimony as applying to the company's other incentive compensation plans.

1 **Q. Who has the responsibility for justifying inclusion of incentive compensation costs**
2 **in computing revenue requirement?**

3 **A.** The Commission has repeatedly made it clear that the company must demonstrate
4 ratepayer benefit for the programs costs to be considered in setting rates.

5 **Q. Did the Company demonstrate ratepayer benefits for each of its incentive**
6 **compensation plans?**

7 **A.** No. The Division has given the Company the benefit of the doubt in allowing some of the
8 costs and recommended disallowance of costs based entirely upon attaining earnings
9 goals.

10 **Q. In all of the company's incentive compensation plans, what happens to the money**
11 **collected from ratepayers if:**

12 **1. The Commission approves rates based upon revenue requirement which**
13 **includes such costs, and**

14 **2. In future years, if the incentive compensation plan goals are not met?**

15 **A.** Effectively, the money is taken from ratepayers and transferred to shareholders. The
16 Commission made the following observation in an earlier case.

17 Docket No. 93-057-01, page 46: We will be guided by the uncontested fact that
18 any amount permitted in rates but not paid to employees for meeting goals will go,
19 other things being equal, to shareholders.

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

21 **A.** Yes.

PacifiCorp Sept 2000 Test Year
Disallow Incentive Compensation Costs

Adj

	Acc't	Type	Total Company	Factor	Factor %	Utah Allocation
ust	500	1	(\$3,885,575)	SNPPS	0.370882	(\$1,441,090)
	514	1	(\$60,840)	SNPPS	0.370882	(\$22,564)
me	535	1	(\$720,636)	SNPPH	0.370882	(\$267,271)
	547	1	(\$20,596)	SE	0.369976	(\$7,620)
nt	560	1	(\$251,756)	SNPT	0.370882	(\$93,372)
	580	1	(\$13,601,082)	SNPD	0.373931	(\$5,085,866)
to	911	1	(\$124,196)	CN	0.437419	(\$54,326)
	921	1	(\$12,487,091)	SO	0.370882	(\$4,631,237)
Exp	Totals:	0	(\$31,151,773)	0	0.000000	(\$11,603,347)

PacifiCorp included the costs of some of its incentive compensation in its filing. A portion of the current incentive compensation plans do not comply with past Commission instructions. This adjustment disallows those costs.

PERFORMANCE SHARE APPROXIMATIONS

Line #	Item	Amount	Source
1			
2	Lines 3 through 11 are costs as reported by the Company		
3	Expense Allocable to:		
4	Line-of-Sight Goals	30,075,873	Data Resp 8.14d
5	Earnings Goals	17,806,856	Data Resp 8.14d
6	SubTotal	47,882,729	Data Resp 8.14d
7	Capital Allocable to:		
8	Line-of-Sight Goals	10,930,982	Data Resp 8.14d
9	Earnings Goals	817,465	Data Resp 8.14d
10	SubTotal	11,748,447	Data Resp 8.14d
11	TOTAL Electric Expenses	59,631,176	Data Resp 8.14d

12 Lines 13 through 15 take out the WES costs which are to be allowed. This action assumes that the WES costs are in the "total" figures reported in 8.14d. If they are not, this adjustment should not be made.

13	Line-of-Sight Goals	30,075,873	Line 4
14	WES Costs Allowed	(2,968,793)	Data Resp 8.14e, 557
15	Line-of-Sight without WES	27,107,080	Line 13 minus Line 14

16 Lines 17 through 19 show the Group Performance Award of the Performance Share Program and the Earnings goals for both the Performance Share and Executive Incentive Programs.

17	Disallowed 1/2 Line-of-Sight	13,553,540	Half of Line 15
18	Disallowed Earnings Goals	<u>17,806,856</u>	Line 5
19	Total disallowed	31,360,396	Line 17 plus Line 18

20 Lines 20 and 21 calculate the Utah portion to be disallowed

21	Approx Allocation Factor	0.37	
22	Utah Disallowed	11,603,347	Line 21 times Line 19

23 The amounts in the "Total Company" column, below, were adjusted in proportion to the numbers provided in Data Response 8.14e for the accounts indicated. This distribution of costs will have to be redone upon receipt of better data from the company.

Acc't	Type	Total Company	Factor	Factor %	Utah Allocation
24 500	1	(\$3,885,575)	SNPPS	0.370882	(\$1,441,090)
26 514	1	(\$60,840)	SNPPS	0.370882	(\$22,564)
27 535	1	(\$720,636)	SNPPH	0.370882	(\$267,271)
28 547	1	(\$20,596)	SE	0.369976	(\$7,620)
29 560	1	(\$251,756)	SNPT	0.370882	(\$93,372)
30 580	1	(\$13,601,082)	SNPD	0.373931	(\$5,085,866)
31 911	1	(\$124,196)	CN	0.437419	(\$54,326)
32 921	1	<u>(\$12,487,091)</u>	SO	0.370882	<u>(\$4,631,237)</u>
33 Totals:		(\$31,151,773)			(\$11,603,347)

