

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY :
: :
Proposed general increase in electric rates, general :
restructuring of rates, price unbundling of bundled : No. 05-0597
service rates, and revision of other terms and :
conditions of service :

Rebuttal Testimony on Rehearing of

RICK PEARSON

Managing Principal

Towers Perrin

On Behalf of Commonwealth Edison Company

October 25, 2006

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1 **I. Introduction and Background**

2 **A. Identification of Witness**

3 Q. What is your name and business address?

4 A. My name is Rick Pearson. I am employed by Towers Perrin at 71 South Wacker
5 Drive, Suite 2600, Chicago, Illinois 60606.

6 Q. What is your position at Towers Perrin?

7 A. I am the Managing Principal of the Chicago Consulting Office of Towers Perrin.

8 **B. Purpose of Testimony**

9 Q. What is the purpose of your rebuttal testimony on rehearing?

10 A. I was asked to respond to the testimony on rehearing of Staff witness Peter
11 Lazare. Mr. Lazare observes that ComEd presented information in its testimony
12 on rehearing that shows its health care costs for active employees rose about 88%
13 from 2000 to 2004, whereas a Towers Perrin study shows that on average health
14 care costs rose about 63% over that same period. This prompted Mr. Lazare to
15 ask “why ComEd cannot keep up with the average when it comes to controlling
16 health care costs.” ICC Staff Ex. 27.0, 15:366-16:367. I will address the question
17 posed by Mr. Lazare. In my rebuttal testimony on rehearing, I will explain: (1)
18 the growth in health care costs for all employers, and specifically ComEd, in the
19 period between 2000 and 2004; and (2) why ComEd’s increased health care costs
20 from 2000 to 2004 are reasonable even though they exceeded the average increase
21 in such costs during that period.

22 **C. Summary of Conclusions**

23 Q. Stated briefly, what are your conclusions?

24 A. In brief, I conclude as follows:

25 (1) Health care costs for all employers in the period between 2000 and 2004
26 grew significantly. This growth far exceeded general inflation, and is due
27 to a number of drivers, including the increased utilization of medical
28 services and procedures in general, increased utilization and cost of
29 prescription drug treatments, increased utilization of technology, and the
30 aging of the population. Moreover, the growth in costs has generally
31 affected the energy and utilities industries, including ComEd, more than
32 other employers.

33 (2) The increased health care costs experienced by ComEd are reasonable
34 because such costs are within the range experienced by other employers in
35 the energy and utilities industries, and because ComEd has taken
36 reasonable steps to mitigate the effect of these increased costs.

37 **D. Background and Experience**

38 Q. What is your educational and professional background?

39 A. I have been with Towers Perrin for over 33 years, and during that time I have held
40 a variety of positions. I have worked extensively on the design, funding,
41 administration and communication of retirement, group and other employee
42 benefit plans. I have specialized in integrating retirement and group plans into my
43 clients' overall business strategy. I received a Bachelor of Science degree in
44 actuarial mathematics from the University of Iowa. I am a Fellow of the Society

45 of Actuaries, a Member of the American Academy of Actuaries, and an Enrolled
46 Actuary under the Employee Retirement Income Security Act (“ ERISA”). I am
47 also a past president of the Wisconsin Retirement Plan Professionals and a former
48 instructor for the International Foundation of Employee Benefits.

49 Q. What is Towers Perrin and what services does Towers Perrin provide?

50 A. Towers Perrin is one of the world’s largest management and human resources
51 consulting firms, helping organizations manage their investment in people to
52 achieve performance improvements. The firm has approximately 5,000
53 employees in 78 offices worldwide. Towers Perrin’s employee benefits practice
54 is one of the largest in the world with over 900 consultants. Towers Perrin has
55 practitioners with energy and utility industry expertise, such as me, who
56 specialize in employee benefits. Towers Perrin provides services in these areas to
57 numerous utility companies across the country.

58 Q. What is the nature of your relationship with ComEd?

59 A. I have been actively involved in the development, implementation, and ongoing
60 review of health care strategy for both active and retired employees of ComEd for
61 over five years. This includes the design of ComEd’s various health care plans
62 and the contribution strategies implemented by ComEd.

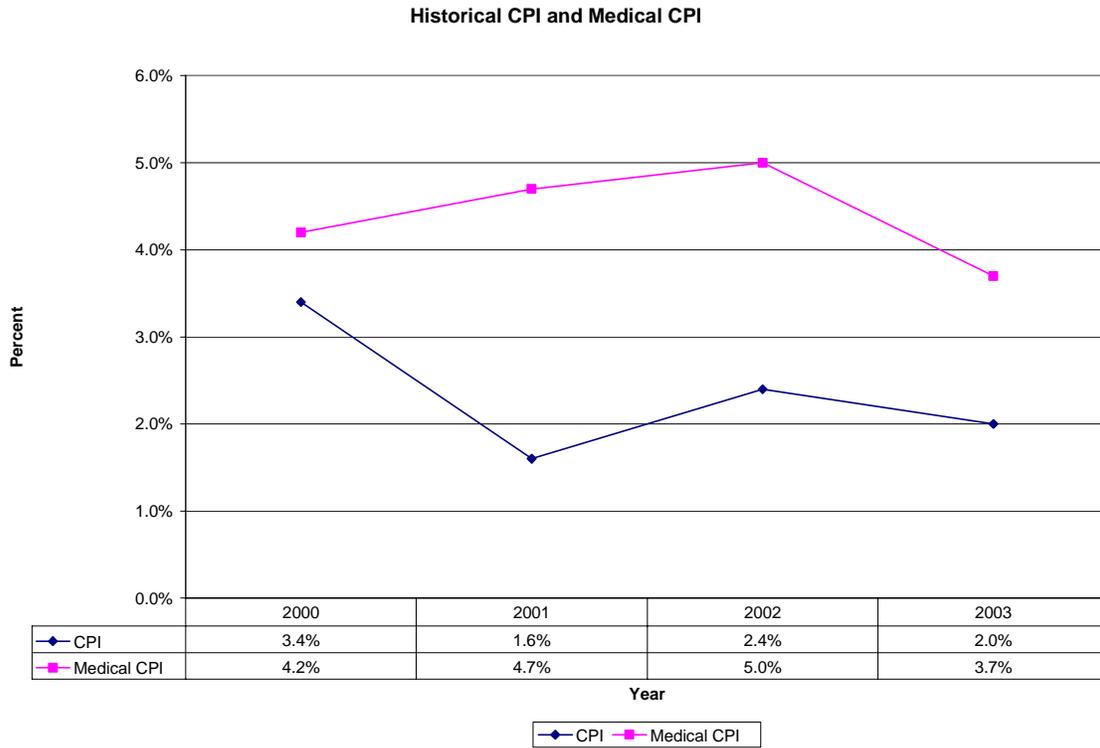
63 **II. The Growth in Health Care Costs in the Period Between 2000 and 2004**

64 Q. What is the purpose of your discussion of the growth in health care costs between
65 2000 and 2004?

66 A. The purpose of this discussion is to provide the Commission with a context from
67 which to view the increase in ComEd's health care costs, for active employees,
68 between the test year of 2000 used in ComEd's last rate case, Docket No. 01-
69 0423, and the test year of 2004 used in this rate case.

70 Q. Generally, what is the magnitude of the increase in health care costs between
71 2000 and 2004?

72 A. Generally, as Mr. Lazare notes, employer health care costs for active employees
73 have increased by 63% between 2000 and 2004 for active employees. This rate of
74 increase is far greater than the 9.7% that the Commission determined was the rate
75 of general inflation for this time period. Moreover, the Consumer Price Index
76 ("CPI") for the year ending 2003 shows the difference in the rate of growth
77 between health care costs and general inflation in sharp relief, as the medical
78 portion of the CPI was nearly twice as much as the overall CPI, as shown below:



79

80 Q. Mr. Lazare cites to and relies upon a Towers Perrin study that has been identified
81 as ComEd Ex. 52.5 Did you participate in the preparation of that Exhibit?

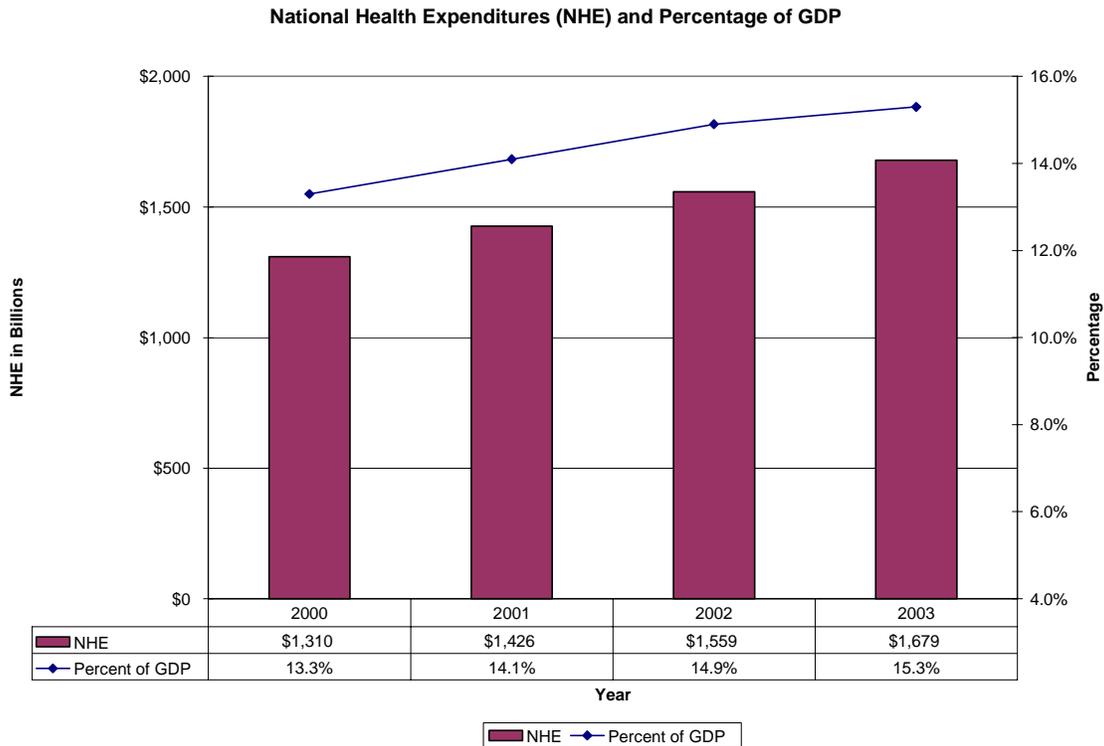
82 A. Yes. For the past seventeen years, Towers Perrin has surveyed, analyzed, and
83 reported on major trends in employee and retiree health care costs, and I have
84 assisted in this for the past five years.

85 Q. How was the study reflected in ComEd Ex. 52.5 prepared?

86 A. Study participants were asked to report their 2006 per capita costs for medical and
87 dental plans. A total of 383 employers, with operations in numerous locations
88 nationwide, responded. Collectively, the participating companies provide medical
89 benefits to approximately 5.6 million U.S. employees, retirees, and dependents.

90 Q. Do other sources show similar growth in health care costs between 2000 and
91 2004?

92 A. Yes. A good example of the increase is shown by viewing national health
 93 expenditures as a percentage of the gross domestic product (“GDP”). In 2000,
 94 national health expenditures accounted for \$1.31 trillion which was 13.3% of the
 95 GDP. In 2004, national health expenditures rose to \$1.805 trillion, which was
 96 15.4% of the GDP.¹



97
 98 Q. Why have health care costs increased between 2000 and 2004?

99 A. A number of drivers have increased health care costs for all employers since
 100 2000. First, employees have increased their utilization of medical services and
 101 procedures in general. Increasing consumer advertising and an aging baby boom
 102 population coupled with greater access to information about new medical
 103 advances are driving demand for costly diagnostic tests and medical procedures,

¹ See Blue Cross Blue Shield Association Medical Cost Reference Guide 2006, p.7.

104 as well as increased use of specialists in fields such as cardiology,
105 gastroenterology, and dermatology. For example, the number of magnetic
106 resonance imaging procedures (“MRIs”) increased in this country from 281
107 million to 374 million between 2000 and 2004.² Second, prescription drug
108 spending in this country increased from \$120 billion to \$190 billion between 2000
109 and 2004.³ Indeed, prescription drug costs have outpaced inflation three to
110 fourfold and grew 10% to 20% *annually* over the relevant time period. Much of
111 this cost increase is due to use of more expensive brand-name drugs, aggressive
112 marketing by drug companies, increased physician-product promotions, and an
113 increasingly older work-force that relies on prescription drugs to treat a growing
114 number of age-related medical conditions. Accordingly, physicians have become
115 more and more likely to prescribe drug treatments. In addition, reductions in
116 government reimbursements have led to cost shifting that is often passed on to
117 medical plan sponsors such as ComEd.

118 Q. Has the increase in health care costs affected all industries in the same manner?

119 A. The greater impact of increased health care costs that employers in the energy and
120 utilities industries have experienced is related to the history of the industries and
121 the collective bargaining process. Many of these employers, including ComEd,
122 are dealing with legacy benefit plans that were designed decades ago to offset
123 lower salaries with more fulsome benefits packages. As salaries in these
124 industries begin to rise toward market levels, many of these employers, including

² See Blue Cross Blue Shield Association Medical Cost Reference Guide 2006, p. 48.

³ See Caremark Trends Rx Report 2006, p. 7.

125 ComEd, have worked to manage the increase in costs of benefit plans to maintain
126 a proper balance in total compensation. ComEd has only a limited amount of
127 control over a large portion of these costs, however, as they are within the
128 mandate of the collective bargaining process. Approximately 32% of ComEd's
129 employees are members of the International Brotherhood of Electrical Workers
130 Local 15 union. For the period under consideration all ComEd employees had
131 essentially the same benefit plan as that negotiated with the IBEW, although the
132 Company has been able to apply some cost control measures "asymmetrically,"
133 that is, to non-union members only.

134 **III. ComEd's Health Care Costs**

135 Q. Are you aware of the magnitude of ComEd's increased health care costs?

136 A. Yes. As Ms. Houtsma explained in her direct testimony on rehearing (ComEd
137 52.0, p. 7:118-22), after considering the impact of fewer employees in 2004,
138 ComEd's health care costs for active employees increased by \$13.7 million over a
139 year 2000 base of \$15.6 million. As Mr. Lazare notes, this reflects a total
140 increase of approximately 88% between 2000 and 2004.

141 Q. In general, what portion of health care contributions are paid by employees?

142 A. On average, employees were responsible for 20% of their health care
143 contributions through payroll deductions.

144 Q. How do those figures compare to the same breakdown for ComEd in 2004?

145 A. ComEd is squarely within this average. ComEd's active employees contributed
146 20% of the cost of their medical plan through payroll deductions in 2004.

147 Q. What was the trend in relative employee total cost sharing for ComEd's health
148 care between 2000 and 2004?

149 A. In general, employees bore a larger percentage of total health care costs under the
150 ComEd plans in 2004 than they did in 2000.

151 Q. Are ComEd's health care cost increases consistent with the general growth in
152 health care costs that you discussed above?

153 A. Yes. The increased health care costs experienced by ComEd are within the range
154 experienced by other employers in the energy and utilities industries. I should
155 emphasize that just because the average healthcare cost increase was 63%, that
156 does not mean that cost increases of more than 63% are unreasonable. For an
157 average figure to be average, there must be cost increases above as well as below
158 that figure. Being above average is, in and of itself, not suggestive of any
159 imprudence. Companies can be above average for any number of reasons other
160 than imprudent conduct. It should be noted that ComEd, lying as it does within
161 the mainstream of cost increases, is not an outlier in this regard -- and its
162 healthcare plan for employees is not extravagant. To put these figures into some
163 sort of context, a company whose cost increases were at the 90th percentile for
164 each year from 2001 through 2004 would have a cumulative increase of 227%,
165 significantly more than the 88% recorded by ComEd

166 Q. Has ComEd done anything to mitigate these increased health care costs?

167 A. Yes. ComEd has taken a number of proactive steps to mitigate the effect of these
168 increased costs.

169 Q. Can you please describe a few of these mitigation efforts?

170 A. Yes. In 2002, for example, ComEd implemented, through coinsurance, a
171 transition from 100% payment of out-of-pocket health care costs to 90% payment
172 of out-of-pocket health care costs. ComEd also increased the prescription drug
173 co-pay for active non-union employees in a change designed to provide an
174 incentive to use generic drugs and utilize lower cost prescription fulfillment
175 services such as mail order, which eliminates the cost involved when a pharmacist
176 dispenses the medication and also allows for less expensive bulk purchases.
177 These measures were implemented for non-union employees only.

178 Q. Did ComEd attempt to implement any of these mitigation measures with its union
179 employees between 2000 and 2004?

180 A. ComEd has discussed these mitigation measures with union representatives. The
181 union remains resistant to management's proposed changes.

182 Q. Are the savings resulting from the mitigation measures discussed above already
183 reflected in the health care costs that ComEd seeks to recover in this proceeding?

184 A. Yes. All of the programs discussed above were implemented prior to or during
185 2004. Thus, the cost savings resulting from these programs is already reflected in
186 the increase in health care costs for which ComEd is seeking reimbursement.

187 Q. Did ComEd implement any other mitigation measures?

188 A. Yes. Among other things, ComEd engaged and educated its employees in
189 consumer driven behaviors, managed its vendors to improve vendor performance

190 and reduce associated administrative costs, and introduced disease management
191 programs to lessen the financial impact of serious health conditions.

192 Q. What is the basis for your knowledge about ComEd's mitigation efforts?

193 A. I have first hand knowledge of ComEd's mitigation efforts because I assisted in
194 the design and implementation of these programs.

195 Q. How do ComEd's mitigation measures compare to those implemented by other
196 employers?

197 A. ComEd's mitigation activities were similar to those put into effect by employers
198 generally and energy/utility employers specifically.

199 Q. In your opinion, are ComEd's increases in health care costs reasonable?

200 A. Yes. The growth in ComEd's employee health care costs is reasonable because
201 its plan for employees has the characteristics of typical large-employer healthcare
202 plans, the costs of its plan are within the range experienced by other employers in
203 general and in the energy and utilities industries, and ComEd has taken reasonable
204 steps to mitigate the effect of these increased costs.

205 Q. Does this conclude your rebuttal testimony on rehearing?

206 A. Yes.