

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

NORTH SHORE GAS COMPANY	:	
	:	
Proposed General Increase In Rates For Gas Service.	:	No. 07-0241
	:	and
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	No. 07-0242
	:	Consol.
	:	
Proposed General Increase In Rates For Gas Service.	:	

Surrebuttal Testimony of

**JAMES C. HOOVER**

Director – Compensation -  
Integrys Energy Group, Inc.

and

**FRANK L. VOLANTE**

Operations Manager  
North Shore Gas Company

On Behalf of  
The Peoples Gas Light and Coke Company and  
North Shore Gas Company

September 5, 2007

## TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND BACKGROUND	1
A. Witness Identification	1
B. Purposes of Testimony	1
C. Summary of Conclusions	2
D. Background and Experience (Mr. Volante)	2
E. Itemized Attachments to Surrebuttal Testimony	3
II. INCENTIVE COMPENSATION	3

1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Witness Identification**

3 Q. Please state your names.

4 A. James C. Hoover. Frank L. Volante.

5 Q. Mr. Hoover, are you the same James C. Hoover who submitted Rebuttal Testimony on  
6 behalf of The Peoples Gas Light and Coke Company (“Peoples Gas”) and North Shore  
7 Gas Company (“North Shore”) (together, “the Utilities”) in this consolidated Docket?

8 A. Yes.

9 Q. Mr. Volante, what is your business address?

10 A. 3001 Grand Avenue, Waukegan, Illinois 60085

11 Q. By whom and in what capacity are you employed?

12 A. I am the Operations Manager of North Shore. Prior to assuming this position on June 24,  
13 2007, I was the Manager, Compensation, for Peoples Energy Corporation.

14 **B. Purposes of Testimony**

15 Q. What is the purpose of your Surrebuttal Testimony in this proceeding?

16 A. The purpose of our Surrebuttal Testimony is to respond to the respective Rebuttal  
17 Testimony of Illinois Commerce Commission (the “Commission”) Staff (“Staff”) witness  
18 Bonita Pearce and “GCI”<sup>1</sup> witness David Effron on their proposed disallowances of  
19 incentive compensation program expenses.

---

<sup>1</sup> The Illinois Attorney General’s Office (the “AG”), the Citizens Utility Board (“CUB”), and the City of Chicago (the “City”) (collectively “GCI”) jointly submitted the testimony of three witnesses, including Mr. Effron.

20 **C. Summary of Conclusions**

21 Q. Please summarize the conclusions of your Surrebuttal Testimony.

22 A. In brief, Staff witness Ms. Pearce's and GCI witness Mr. Effron's respective proposals to  
23 disallow incentive compensation program expenses should be rejected. Their Rebuttal  
24 Testimony does not deny that the incentive compensation plans are prudently and  
25 reasonably designed in order to attract and retain a sufficient, qualified, and motivated  
26 work force. Moreover, they have failed to refute the fact that substantial portions of the  
27 payouts under the plans are based on criteria that directly benefit customers under the  
28 standards that Staff cites. Their Rebuttal Testimony, like their Direct Testimony, fails to  
29 justify the proposed disallowances. In the alternative, Peoples Gas and North Shore  
30 should be allowed to recover the portions of the expenses in question that are  
31 "operational" or "non-financial", rather than "financial". as detailed in the Rebuttal  
32 Testimony of James Hoover and below. (We are using those two terms based on our  
33 understanding of Ms. Pearce's Direct Testimony, as James Hoover did in his Rebuttal  
34 Testimony.)

35 **D. Background and Experience (Mr. Volante)**

36 Q. Mr. Volante, what were your duties as Manager of Compensation for Peoples Energy  
37 Corporation?

38 A. My position was responsible for the overall management of compensation program  
39 design and administration for Peoples Energy Corporation and all its subsidiaries.

40 Q. Mr. Volante, please summarize your professional experience.

41 A. My professional experience in Human Resources ("HR") covers a period of over 28 years  
42 with Peoples Energy Corporation and its subsidiary companies. I have experience in all

43 areas of Human Resources and have approximately 10 years experience in compensation.  
44 I am a Senior Professional in Human Resources (“SPHR”) and a Certified Compensation  
45 Professional (“CCP”).

46 Q. Mr. Volante, please summarize your educational background.

47 A. I received a bachelor’s degree in business administration from DePaul University in 1977  
48 and a Master’s of Business Administration degree from DePaul in 1980.

49 **E. Itemized Attachments to Surrebuttal Testimony**

50 Q. Are you sponsoring any attachments to your Surrebuttal Testimony?

51 A. Yes. We are sponsoring:

- 52 • North Shore / Peoples Gas Exhibit (“Ex.”) JCH-2.1, which is a copy of the  
53 Utilities’ response to Staff data request BAP 15.03; and
- 54 • North Shore / Peoples Gas Ex. JCH-2.2, which is a copy of the Utilities’ response  
55 to Staff data request BAP 15.01, except that it does not include its confidential  
56 attachment.

57 **II. INCENTIVE COMPENSATION**

58 **A. Standards**

59 Q. In her Rebuttal Testimony, does Ms. Pearce accept the premise that, if the incentive  
60 compensation plans are prudently and reasonably designed in order to attract and retain a  
61 sufficient, qualified, and motivated work force, then the expenses of these plans should  
62 be allowed to be recovered through rates?

63 A. No. On page 6, lines 125-129, of her Rebuttal Testimony (Staff Ex. 14.0), Ms. Pearce  
64 makes clear that even if the plans are so designed here, which she does not deny, that  
65 “does not detract from the basis for my adjustment.”

66 Q. Do you agree with Ms. Pearce’s view on that point?

67 A. No. Although she states her understanding of the standard in different ways, she  
68 indicates that incentive program plan expenses should be allowed to be recovered through  
69 rates if they provide net benefits to ratepayers. (Staff Ex. 14.0, page 6, lines 131-134).  
70 The Utilities’ having a sufficient, qualified, and motivated work force certainly benefits  
71 ratepayers. No witness has denied that.

72 Q. Does Ms. Pearce in her Rebuttal Testimony espouse consistent standards for when  
73 incentive compensation program expenses should be allowed to be recovered through  
74 rates?

75 A. No, not in our opinion. While net benefits to ratepayers seems to be the core of the  
76 standards she advocates, some benefits seem to be disallowed under her approach, on  
77 grounds that we do not find to be consistent. As noted above, having a sufficient,  
78 qualified, and motivated work force seems not to count under her approach. Moreover,  
79 while she calls for proof of “specific dollar savings or other tangible benefits” in order to  
80 obtain cost recovery (*e.g.*, Staff Ex. 14.0, page 6, lines 134-138), she later claims that  
81 controlling Operations and Maintenance (“O&M”) expenses does not count, either, on  
82 the theory that it benefits shareholders more than ratepayers (*id.* at page 11, lines  
83 237-244). She subsequently asserts that controlling expenses recovered through the  
84 Utilities’ Gas Charges also does not count. (*Id.* at page 12, lines 254-275) So, it would  
85 seem that specific dollar savings count, that is, unless they involve controlling O&M

86 expenses or gas purchase expenses, in which case they do not count under her approach.  
87 O&M expenses are part of a utility's revenue requirement. Reducing O&M expenses  
88 benefits customers by ultimately reducing rates. Gas expenses are recovered through Gas  
89 Charges. Reducing them benefits customers. To the extent that Ms. Pearce's argument is  
90 a legal argument, as seems to be the case with regard to gas expenses and Gas Charges, in  
91 particular, that is beyond the scope of our testimony and will be addressed by the Utilities  
92 in briefing.

93 Q. Does Mr. Effron's Rebuttal Testimony justify any standards or any other grounds that  
94 would warrant his proposed adjustments?

95 A. No. Mr. Effron's Rebuttal Testimony on the subject of incentive compensation program  
96 expenses does not seem very substantive. He claims, with no meaningful elaboration,  
97 that the Rebuttal Testimony of James Hoover does not demonstrate that the plans "ha[ve]  
98 reduced expenses and created greater efficiencies in operations", which he indicates is  
99 what he understands to be the Commission generally to have required in order to obtain  
100 cost recovery. (GCI Ex. 5.0, page 10, line 243, to page 11, line 254) Otherwise, he  
101 simply increases his proposed adjustments to match those of Ms. Pearce. (*Id.* at page 11,  
102 lines 256-266) Accordingly, the remainder of our Surrebuttal Testimony addresses  
103 Ms. Pearce's Rebuttal Testimony, but, in doing so, it also responds to that of Mr. Effron.

104 **B. The Team Incentive Awards (TIA) Plan**

105 Q. The Rebuttal Testimony of James Hoover stated that awards under the Team Incentive  
106 Awards plan for fiscal year 2006, the test year, were in fact based 45% on "operational  
107 measures". Did Ms. Pearce, in her Rebuttal Testimony, attempt to refute the Rebuttal  
108 Testimony of James Hoover on that point?

109 A. Yes, in part, but she did not succeed, for several reasons. First, she acknowledges that  
110 25% (25% out of the total 100% of measures) in the test year was based on controlling  
111 O&M expenses. As we noted above, her theory that controlling O&M expenses does not  
112 count as a customer benefit is incorrect. Moreover, Peoples Gas and North Shore have  
113 provided additional supporting evidence of customer benefits from this measure, i.e.,  
114 reductions in actual O&M expenses below target levels, which are based on the Utilities’  
115 budgets, in response to Staff data request BAP 15.03, a copy of which is attached hereto  
116 as North Shore / Peoples Gas Ex. JCH-2.1. We believe that, while not the only factor, the  
117 incentive compensation measure was a contributing factor in the reductions. In fiscal  
118 year 2006, the test year, aggregate actual O&M expenses for the Utilities were about \$11  
119 million below the budget, as shown in that exhibit. With regard to the relationship  
120 between the test year’s lower level of O&M expenses and the Utilities’ proposed revenue  
121 requirements, please see the respective Direct Testimony of North Shore and Peoples Gas  
122 witnesses Linda Kallas and Salvatore Fiorella.

123 Second, Ms. Pearce agrees that the 10% (out of 100%) measure tied to number of  
124 calls to the call centers does provide direct ratepayer benefits. (Staff Ex. 14.0, page 11,  
125 lines 246-251) We see nothing in her Rebuttal Testimony that would warrant anything  
126 other than allowing the expenses associated with that measure to be recovered through  
127 rates. Later on, she says that allowing recovery of 10% of the test year TIA amount  
128 based on this measure would be the “least objectionable” alternative result (Staff  
129 Ex. 14.0, page 19, lines 430-432), but, as shown above, she has made no valid objection.

130 Third, Ms. Pearce’s arguments regarding why she believes the 10% (out of 100%)  
131 measure that is associated with gas expenses and Gas Charges should not count is

132 inconsistent with the standards she cites, as we noted above. Moreover, to the extent that  
133 it is based on a legal argument, it will be the subject of briefing, as we also noted earlier.  
134 Ms. Pearce notes that in fiscal year 2006, Peoples Gas and North Shore did not pay out  
135 under the 10% gas expenses / Gas Charges measure. However, she fails to mention the  
136 payout figures associated with the other two operational measures. Ms. Kallas, in her  
137 Rebuttal Testimony, already pointed out that, under the TIA plan, in fiscal year 2006:

138 Peoples Gas accrued \$1,465,444, while North Shore accrued  
139 \$142,124. Peoples Gas paid out \$1,502,584 of which \$1,009,240 was paid  
140 on the operational performance measures. North Shore paid out \$140,253,  
141 of which \$94,204 was paid on the operational measures.

142 (North Shore / Peoples Gas Ex. LK-2.0, page 9, lines 183-185) Ms. Kallas' work paper  
143 WP LK-2.0 (1) of (2) confirms that while the accruals were based 45% on the above  
144 operational measures, 67.2% (rounded) (of the total 100%) of the payouts were based on  
145 the controlling O&M expenses (48.4%) (rounded) and call centers (18.8%) (rounded)  
146 measures referenced above.

147 Accordingly, while complete recovery is warranted, in the alternative, even under  
148 Ms. Pearce's approach, Peoples Gas should recover \$1,009,240 of the test year TIA plan  
149 expenses through rates and North Shore should recover \$94,204.

150 Q. Ms. Pearce also makes the point, however, that the TIA plan measures may change from  
151 year to year. (Staff Ex. 14.0, page 10, lines 207-229) Does that warrant denying  
152 recovery of any or all of the fiscal year 2006 TIA plan expenses?

153 A. No, for several reasons. First, as indicated by the figures in the Direct Testimony of  
154 Ms. Pearce (Staff Ex. 2.0, Schedule 2.2P, page 2, line 7, and Schedule 2.2N, page 2,  
155 line 7, and the Rebuttal Testimony of Linda Kallas (North Shore/Peoples Gas

156 Ex. LK-2.0, page 9, line 183), the amounts in the Utilities' proposed revenue  
157 requirements are based on the actual accruals for the test year.

158 Second, as shown in Ms. Kallas' Rebuttal Testimony (page 9, lines 183-185) and  
159 her work paper, as discussed above, the operational payouts in the test year were actually  
160 much higher than their 45% proportionate share of the accruals.

161 Third, Ms. Pearce contradicts herself. Here, she says that different measures  
162 could be applied in later years. Yet, in response to the Rebuttal Testimony of James  
163 Hoover regarding the 2007 non-executive incentive compensation plan, which  
164 Mr. Hoover provided as a work paper, just a few pages later she claims it is irrelevant,  
165 stating in part that:

166 However, it is not reasonable to apply those incentive measures to the  
167 incentive compensation expenses that the Companies seek to recover in  
168 the instant proceeding.

169 The 2006 test year includes expenses based on the specific Plans in effect  
170 during the year when the Companies were not under the management of  
171 WPS. Those 2006 plans form the basis for the determination of  
172 ratemaking treatment of those costs in this proceeding.

173 (Staff Ex. 14.0, page 18, lines 394-401)

174 Finally, Ms. Pearce notes that the 2007 non-executive plan includes some  
175 "financial" measures, but she also admits that 50% of the measures as to non-executives  
176 are comprised of the following operational measures: customer value (customer  
177 satisfaction), system reliability, customer rates, employee safety, and diversity. (Staff Ex.  
178 14.0, page 18, line 402, to page 19, line 415). All of those operational measures should  
179 be considered to meet her standards, if those standards are assumed to apply. The 2007  
180 non-executive plan provides for payouts at target levels as to Peoples Energy Corporation  
181 of \$1,400,000, as to Peoples Gas of \$1,625,000, and as to North Shore of \$155,000.

182           **C.     The Individual Performance Bonus (IPB) Plan**

183    Q.     Ms. Pearce speculates that the total pool from which the fiscal year IPB plan awards were  
184           paid might be “somehow related to the financial performance of the Companies”. (Staff  
185           Ex. 14.0, page 13, line 294-206. Were they related?

186    A.     No. The pool was a fixed amount that was not based on financial performance. Nor  
187           were the awards based on financial performance, as previously pointed out in the  
188           Rebuttal Testimony of James Hoover, and which Ms. Pearce does not contest.

189    Q.     Did the IPB plan benefit customers?

190    A.     Yes, the IPB plan benefited customers by encouraging outstanding individual work  
191           performance, as discussed in more detail in North Shore / Peoples Gas Ex. JCH-2.2,  
192           which is a copy of the Utilities’ response to Staff data request 15.01. Accordingly, even  
193           in the event that the Commission were to decide to disallow some other incentive  
194           compensation expenses, it should allow the amounts paid out under the IPB plan, which  
195           are \$625,791 as to Peoples Gas and \$53,107 as to North Shore, as noted in Ms. Kallas’  
196           Rebuttal Testimony (North Shore / Peoples Gas Ex. LK-2.0, page 9, lines 188-189).

197    Q.     Ms. Pearce states that the Rebuttal Testimony of James Hoover did not establish specific  
198           dollar savings and other tangible benefits from the IPB Plan. (Staff Ex. 14.0, page 13,  
199           line 298, to page 14, line 300) Is that a reasonable requirement here?

200    A.     No. The pool is not tied to financial performance, and the awards are not based on  
201           financial performance. Moreover, as was shown in the confidential attachment to the  
202           Utilities’ response to Staff data request BAP 15.01, the IPB awards went to 426 different  
203           employees, in an average amount of \$2,884.53. The Utilities should not be expected to

204 discuss the basis of 426 different awards, given the non-financial nature of the IPB plan,  
205 the burdensomeness of such a demonstration, and the privacy interests of the employees.

206 Q. Ms. Pearce also makes the point that the IPB Plan was a new plan in fiscal year 2006, and  
207 that it has not been continued. (Staff Ex. 14.0, page 14, lines 300-305) Does that warrant  
208 disallowing the test year amounts for the IPB Plan?

209 A. No. As we noted above, the 2007 non-executive plan was provided as a work paper to  
210 the Rebuttal Testimony of James Hoover, and it shows that 50% of the measures are  
211 operational, and the payout at target levels of that plan as to non-executives of Peoples  
212 Energy Corporation, Peoples Gas, and North Shore are noted above.

213 **D. The Short-term Incentive Compensation (STIC) Plan**

214 Q. Ms. Pearce discusses certain aspects of the measures applicable to Peoples Energy  
215 Corporation senior management for the fiscal year 2006 Short-term Incentive  
216 Compensation plan. (Staff Ex. 14.0, page 14, line 308, to page 15, line 323) How did the  
217 measures under the STIC plan as applicable to Peoples Gas senior management compare  
218 to the fiscal year 2006 TIA plan measures?

219 A. They were the same, as stated in the Rebuttal Testimony of James Hoover.

220 **E. The Restricted Stock and Performance Shares Programs**

221 Q. Ms. Pearce, in her Rebuttal Testimony, states that the Restricted Stock and Performance  
222 Shares programs both are based on “financial” measures. (Staff Ex. 14.0, page 17,  
223 lines 373-374) Is that correct?

224 A. No. As the information that was provided in the Rebuttal Testimony of James Hoover  
225 indicated, as referenced on the preceding page of Ms. Pearce’s Rebuttal Testimony, the

226 restricted stock program was based on providing a competitive compensation package,  
227 not on “financial” measures.

228 **F. Final Recommendation and Alternative Recommendation**

229 Q. What is your final recommendation on recovery of fiscal year 2006 incentive  
230 compensation program expenses through rates?

231 A. For the reasons we have discussed, the Commission should allow recovery of all of the  
232 incentive compensation program expenses included in the Utilities’ proposed revenue  
233 requirements. In the alternative, the Commission should allow recovery as follows:

- 234 • Peoples Gas and North Shore should be allowed to recovery \$1,009,240 and  
235 \$94,204, respectively, under the TIA plan.
- 236 • Peoples Gas and North Shore should be allowed to recover \$625,791 and  
237 \$53,107, respectively, under the IPB Plan.

238 Q. Does this conclude your Surrebuttal Testimony?

239 A. Yes.