

**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.	:	

**AFFIDAVIT OF JAMES C. HOOVER**

STATE OF WISCONSIN    )  
                                  )    SS.  
COUNTY OF BROWN    )

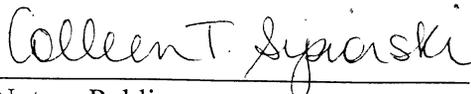
I, James C. Hoover, being first duly sworn, declare under oath as follows:

1. I am Director – Compensation – Integrys Energy Group, Inc., the parent holding company for The Peoples Gas Light and Coke Company and North Shore Gas Company, the Applicants in this proceeding.
2. I provided rebuttal and surrebuttal testimony, identified as North Shore/Peoples Gas Exs. JCH-1.0, JCH/FLV-2.0, JCH/FLV-2.1, and JCH/FLV-2.2, respectively, on behalf of the Applicants. Those pieces of testimony, which are attached to this Affidavit, were prepared by me or under my direction and control.
3. I swear and affirm that the testimony provided is true and correct, to the best of my knowledge and ability, and that there are no corrections or revisions to be made to my testimony. If I were asked the same questions today, my answers would be the same. It is my desire that my testimony be considered as evidence by the Administrative Law Judges and by the Illinois Commerce Commission in this Docket.

FURTHER AFFIANT SAYETH NOT.

  
\_\_\_\_\_  
James C. Hoover

SUBSCRIBED AND SWORN to before me  
this 11<sup>th</sup> day of September, 2007.

  
\_\_\_\_\_  
Notary Public



**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

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

**AFFIDAVIT OF FRANK L. VOLANTE**

STATE OF ILLINOIS     )  
                                  )     SS.  
COUNTY OF COOK     )

I, Frank L. Volante, being first duly sworn, declare under oath as follows:

1. I am Manager, Operations, for North Shore Gas Company, one of the Applicants in this proceeding.

2. I provided surrebuttal testimony, identified as Peoples Gas-North Shore Ex. JCH/FLV-2.0 on behalf of The Peoples Gas Light and Coke Company and North Shore Gas Company, the Applicants, and sponsored Exs. JCH/FLV-2.1 and 2.2. That piece of testimony and those exhibits, which are attached to this Affidavit, were prepared by me and James C. Hoover or under my and Mr. Hoover's direction and control.

3. I swear and affirm that the testimony and exhibits provided are true and correct, to the best of my knowledge and ability, and that there are no corrections or revisions to be made to my testimony and exhibits. If I were asked the same questions today, my answers would be the same. It is my desire that my testimony be considered as evidence by the Administrative Law Judges and by the Illinois Commerce Commission in this Docket.

FURTHER AFFIANT SAYETH NOT.

  
\_\_\_\_\_  
Frank L. Volante

SUBSCRIBED AND SWORN to before me  
this 11 day of September, 2007.

  
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Notary Public



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	:	

Rebuttal Testimony of

**JAMES C. HOOVER**

Director – Compensation -  
Integrys Energy Group, Inc.

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

July 27, 2007

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1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Witness Identification**

3 Q. Please state your name and business address.

4 A. James C. Hoover, Integrys Energy Group, Inc. (“Integrys”). 700 North Adams Street,  
5 Green Bay, Wisconsin, 54307-9001.

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

7 A. I am the Director - Compensation of Integrys. Integrys is the parent corporation of  
8 Peoples Energy Corporation, which in turn is the parent corporation of The Peoples Gas  
9 Light and Coke Company (“Peoples Gas”) and North Shore Gas Company (“North  
10 Shore”) (together, “the Utilities”). (Integrys also has other direct and indirect  
11 subsidiaries.)

12 **B. Purpose of Testimony**

13 Q. What is the purpose of your Rebuttal Testimony in this proceeding?

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

18 **C. Summary of Conclusions**

19 Q. Please summarize the conclusions of your Rebuttal Testimony.

20 A. In brief, Staff witness Ms. Pearce’s and GCI witness Mr. Efron’s respective proposals to  
21 disallow incentive compensation program expenses should be rejected. The incentive

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<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. Efron.

22 compensation plans are prudently and reasonably designed in order to attract and retain a  
23 sufficient, qualified, and motivated work force. Moreover, substantial portions of the  
24 payouts under the plans are based on criteria that directly benefit customers under the  
25 standards that Staff cites.

26 **D. Background and Experience**

27 Q. What are your duties in your position with Integrys?

28 A. My position is responsible for the overall management of compensation program design  
29 and administration for Integrys and all its subsidiaries.

30 Q. Please summarize your professional experience.

31 A. My professional experience in Human Resources (“HR”) covers a period of over 25 years  
32 with various companies. My primary expertise and concentration in the HR area has  
33 been in compensation and benefits design and administration

34 Q. Please summarize your educational background.

35 A. I received a bachelor’s degree in business from Oklahoma State University in 1972.

36 **II. INCENTIVE COMPENSATION**

37 Q. Staff witness Ms. Pearce, on pages 6-18 of her Direct Testimony and in her  
38 Schedules 2.2P and 2.2N, proposes adjustments to operating expenses and rate base to  
39 deny Peoples Gas and North Shore recovery of incentive compensation program costs  
40 (including the associated payroll taxes). What is your understanding of Ms. Pearce’s  
41 rationale for her proposed incentive compensation adjustments?

42 A. As I understand her testimony, her primary argument is that all incentive compensation  
43 program expenses should be disallowed because, in her view: “The Plans are largely

44 dependent upon financial goals of the Companies that benefit shareholders but not  
45 ratepayers.” (Staff Ex. 2.0, 7:148-149)

46 Her fall-back argument is that: “In the future, the goals of the Plans may not be  
47 met and thus the Companies would incur no cost.” (Staff Ex. 2.0, 7:150-151) She also,  
48 as to the latter point, points to the fact that Peoples Gas and North Shore did not pay  
49 incentive compensation to officers in 2006 (Staff Ex. 2.0, 13:287-293) and professes that  
50 her concerns are “exacerbated” because of uncertainty she feels is caused by Integrys  
51 becoming the parent company of Peoples Energy Corporation, which in turn is the parent  
52 of Peoples Gas and North Shore (Staff Ex. 2.0, 13:295-14:321).

53 Q. What role do incentive compensation plans play in employee compensation at the  
54 Utilities?

55 A. The Utilities and other large businesses seek to design employee compensation in order  
56 to attract and retain a sufficient, qualified, and motivated work force. Incentive  
57 compensation programs are a common method to help achieve those objectives. The  
58 Utilities compete in the labor market with other utilities and other businesses that offer  
59 incentive compensation. For these reasons, among others, the costs of such programs are  
60 prudent and reasonable costs of doing business for a large utility.

61 Q. Does a utility’s attracting and retaining a sufficient, qualified, and motivated work force  
62 benefit the utility’s customers?

63 A. Yes. A utility’s attracting and retaining a sufficient, qualified, and motivated work force  
64 benefits its customers, by making sure there are enough employees to perform needed

65 work, by maintaining and improving the productivity and quality of work, and by  
66 reducing the expenses associated with recruiting and training new employees.

67 Q. Did Ms. Pearce offer any testimony on whether the Utilities' incentive compensation  
68 programs or payouts were prudent and reasonable from a human resources management  
69 perspective?

70 A. No, she did not. Nor did Mr. Efron or any other Staff or intervenor witness.

71 Q. On pages 7 to 8 of her Direct Testimony, Ms. Pearce discusses the fiscal year 2006 Team  
72 Incentive Award ("TIA") Plan. To which Peoples Gas and North Shore employees did  
73 the 2006 TIA Plan apply?

74 A. The 2006 TIA plan applied only to non-officer, non-union employees, as noted in the  
75 Utilities' response to Staff data request BAP-4.09.

76 Q. Were the performance measures for the fiscal year 2006 TIA plan tied solely to  
77 "financial" measures, as Ms. Pearce uses the term "financial"?

78 A. No, Ms. Pearce herself acknowledges that there were both "financial" and "operational"  
79 measures for the plan as to fiscal year 2006 as she uses those terms. The operational  
80 measures (using that terminology) were 45% of the measures, The operational  
81 performance measures consisted of a 25% weighting for controlling operations and  
82 maintenance expenses (excluding environmental costs recovered through Rider 11 and  
83 the provision for uncollectible accounts) and a 20% weighting for customer satisfaction  
84 criteria (10% based on the number of calls to the call centers and 10% based on the  
85 ranking of the Utilities' gas charge rates filed each month compared to the gas charge

86 rates of six other Illinois Utilities).<sup>2</sup> These measures were independent; they did not  
87 depend on the results of the “financial” measures. Ms. Kallas, in her Rebuttal Testimony,  
88 discusses the amounts accrued and paid out, including the amounts related to the  
89 operational measures, under the 2006 TIA plan.

90 Q. On page 8 of her Direct Testimony, Ms. Pearce refers to the fiscal year 2006 Individual  
91 Performance Bonus (“IPB”) Plan. To which Peoples Gas and North Shore employees did  
92 the 2006 IPB plan apply?

93 A. The 2006 IPB plan applied only to non-officer, non-union employees, as noted in the  
94 Utilities’ response to Staff data request BAP-4.09.

95 Q. How were payouts determined under the fiscal year 2006 IPB plan?

96 A. The awards were discretionary and not tied to any formula, as Ms. Pearce notes. As the  
97 Utilities’ response to Staff data request BAP-10.02 further explains, each division’s  
98 senior management, with input and direction from their managing staff, was responsible  
99 for calculating and awarding the IPB to their own employees.

100 As the name of the plan suggests, the IPB plan awards were based on the  
101 employee’s individual performance. They were not based on the financial performance  
102 of the Utilities. Also, the pool for the IPB plan awards was a fixed amount, regardless of  
103 the Utilities’ financial performance.

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<sup>2</sup> The cost control measure is described further under the heading “Gas Distribution - Responsibility Costs” on page 2 of 12 of the attachment to the response to Staff data request BAP 10.01. The customer satisfaction criteria are described further in that document on pages 7 and 8 of 12 under the heading “Gas Distribution - Customer Satisfaction”.

104 Q. On pages 9 to 10 of her Direct Testimony, Ms. Pearce discusses the fiscal year 2006  
105 Short-term Incentive Compensation (“STIC”) Plan. To which Peoples Gas and North  
106 Shore employees did the 2006 STIC Plan apply?

107 A. The 2006 STIC Plan applied to Peoples Gas’ senior management as is reflected in the  
108 Utilities’ responses to Staff data requests BAP-4.09 and 10.03. (The latter response notes  
109 that the 2006 STIC Plan accruals were reversed because there were not payouts for that  
110 year, for unusual reasons that are not expected to reoccur.)

111 Q. How did the performance measures for the fiscal year 2006 STIC Plan compare to those  
112 of the fiscal year 2006 TIA Plan?

113 A. The two plans had the same performance measures, which I have discussed above.

114 Q. Parts of Ms. Pearce’s proposed adjustments are based on fiscal year 2006 officers’  
115 incentive compensation and bonuses charged by an affiliate to Peoples Gas and North  
116 Shore. (Staff Ex. 2.0, Schedule 2.2P, page 2, lines 12-13, and Schedule 2.2N, page 2,  
117 lines 12-13) Were the performance measures for those incentive compensation programs  
118 tied solely to financial measures?

119 A. No. In general, although there was some variation as to some officers, 37.5% of the  
120 performance measures were operational, i.e., 25% of the performance measures were  
121 based on controlling corporate cost center controllable costs and 12.5% were based on the  
122 effectiveness of internal controls, with no payout on that measure if there was a material  
123 weakness.<sup>3</sup>

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<sup>3</sup> The cost control measure is described further under the heading “Corporate - Responsibility Costs” on page 2 of 12 of the attachment to the response to Staff data request BAP 10.01. The effective internal controls measure is described further in that document on page 6 of 12 under the heading “Corporate - Internal Controls”.

124 Q. On pages 10 to 11 of her Direct Testimony, Ms. Pearce discusses long-term incentives,  
125 i.e., restricted stock and performance shares, covered by the 2004 incentive compensation  
126 plan, and parts of her proposed adjustments relate to the associated expenses (Staff  
127 Ex. 2.0, Schedule 2.22P, page 2, lines 4, 5, and 14, and Schedule 2.2N, page 2, lines 4  
128 and 5. Are these also expenses charged by an affiliate to Peoples Gas and North Shore?

129 A. Yes. They are charges from Peoples Energy Corporation to Peoples Gas and North  
130 Shore.

131 Q. Please describe the referenced restricted stock program.

132 A. Key management level employees and executives of Peoples Energy Corporation were  
133 eligible to receive restricted stock grants generally each year under the plan. In  
134 determining these long-term incentive grants, the grants were first aligned with market  
135 competitive practices, and they also factored in business operations and current results.  
136 Restricted stock vesting was based on a 20% rate per year so that full vesting occurred at  
137 the end of five years. Thus, the restricted stock grants were based primarily on providing  
138 a competitive compensation package.

139 Q. Please describe the referenced performance shares program.

140 A. Performance shares have specific performance components. The performance measures  
141 utilized for performance shares were Three Year Average Return on Equity and  
142 Annualized Three Year Total Shareholder Return relative to peer companies.

143 Q. When were restricted stock and performance shares most recently provided?

144 A. Equity grants were most recently provided to eligible executives and managers in  
145 October 2005, the first month of fiscal year 2006. No grants were given in Fall 2006,  
146 because of the pending Integrys - Peoples Energy transaction, which since has closed.

147 Q. Should any of the Peoples Gas and North Shore incentive compensation program  
148 expenses that Ms. Pearce proposes to disallow be excluded from the revenue requirement  
149 on the ground that they are based on what she refers to as financial measures?

150 A. No. As I stated earlier, the programs are the product of careful decisions about what  
151 types and levels of incentive compensation are needed in order to attract and retain a  
152 sufficient, qualified, and motivated work force, and these expenses are prudent and  
153 reasonable costs of doing business.

154 In addition, while Ms. Pearce's testimony recognizes that there are distinctions,  
155 her proposed adjustments incorrectly paint all of the expenses with the same "financial"  
156 brush. As shown above, substantial, specified portions of the expenses are targeted and  
157 paid out or otherwise determined based on independent measures that are not "financial"  
158 measures but rather are "operational measures" that are connected with benefiting  
159 customers, such as customer satisfaction and controlling costs. Accordingly, in the  
160 alternative, Ms. Pearce's proposed adjustments to Peoples Gas' and North Shore's  
161 incentive compensation plan expenses should be reduced to permit recovery of: (1) 45%  
162 of the expenses associated with the 2006 TIA and STIC Plan "operational" measures,  
163 (2) all expenses of the 2006 IPB Plan, and (3) 37.5% of the 2006 charged affiliate officers  
164 incentive compensation and bonuses. Recovery of the restricted stock expenses also  
165 should be allowed because their primary driver is not "financial".

166 Q. Should any of the Peoples Gas and North Shore incentive compensation program  
167 expenses that Ms. Pearce proposes to disallow be excluded from the revenue requirement  
168 on the alternative ground that there is uncertainty about future payouts?

169 A. No. The history of payouts negates the stated hypothetical concern. For example, the  
170 Peoples Gas payouts under the TIA Plan related to fiscal years 2004, 2005, and 2006  
171 were \$1,680,418, \$2,293,590, and \$1,502,584, and the North Shore payouts under the  
172 TIA Plan related to those years were \$140,253, \$215,961, and \$155,231, respectively.  
173 Moreover, the fact that Integrys became the parent of Peoples Energy does not justify or  
174 “exacerbate” Ms. Pearce’s stated concern.

175 Q. What is Integrys overall compensation philosophy since closing of the transaction with  
176 Peoples Energy Corporation earlier in the year?

177 A. Like most businesses, utilities, and even governmental agencies, Integrys establishes  
178 compensation programs, which are market-based so it can attract and retain quality and  
179 high performing employees. We compete for quality employees in a market that includes  
180 regulated and non-regulated energy companies as well as non-energy firms. In the next  
181 few years, we will see more and more employees being eligible to retire. Therefore, it is  
182 critical that our compensation plans be competitive both in terms of structure and  
183 compensation levels. Integrys uses data supplied by Towers Perrin Consultants to meet  
184 this objective. Towers Perrin is a nationally recognized large firm that specializes in both  
185 compensation and benefits consulting services.

186 Q. Please describe the incentive compensation plan approval process used by Integrys for  
187 2007.

188 A. The annual incentive plan for Integrys executives is approved by the Compensation  
189 Committee of the Integrys Board of Directors. A similar plan for non-executive  
190 employees of Integrys is approved for use by the Integrys President & Chief Executive  
191 Officer. The incentive plan for non-executive employees utilizes the same performance  
192 measures as that used for executives. This approach has been taken so that employees  
193 and their executives have the same priorities and are compensated for the same  
194 achievements.

195 Q. Please describe the performance measures and weightings used in the incentive  
196 compensation plans for Integrys for 2007.

197 A. An additive scorecard system with results unique to each business unit is used in which  
198 performance against each measure is assessed, weighted and added together to determine  
199 the final payout. Failure to achieve a satisfactory result on one measure will not preclude  
200 payout from another measure.

201 Non-financial measures included customer value, system reliability, customer  
202 rates, employee safety, and diversity. The financial measure was net income.  
203 Non-executive plan participants have a 50% weighting on non-financial measures and  
204 50% on the financial measure. Executives generally have a 75% weighting on the  
205 financial measure but also have unique annual incentive award payout modifiers tied to  
206 special performance measurement criteria associated with the Peoples Energy  
207 Corporation transaction.

208 A brief explanation of each measure is provided below for 2007 performance year  
209 which will be applied to each business unit.

<b>Performance Measure</b>	<b>Explanation</b>
Customer Value	Measures customer survey results as compared to a peer set of regional utilities including Nicor and NIPSCO.
System Reliability	Measures company's ability to deliver quality services by reducing frequency and duration of planned and unplanned interruptions. For only WPSC Energy Projects and Energy Supply Operations, System Reliability is replaced with a Market Effectiveness measure relating to energy prices and earnings based on actual plant operations versus operations if available at 100% of the time.
Customer Rates	Measures customer rates charged by the company as compared to peer group of regional utility companies including Nicor, Ameren-Cilco/Illinois Power.
Employee Safety	Measures lost time injury frequency and costs as compared to budget.
Employee Diversity	Measures women and minorities hired/promoted as compared to all individuals hired/promoted.
Forward Book Value Growth (does not apply to Peoples Gas & North Shore)	Measures economic value of non-regulated business unit portfolio results.
Net Income	Measures net income from operations based on after-tax earnings as compared to budget by business unit.

210 Q. GCI witness Mr. Effron on pages 25-26 of his Direct Testimony and in his  
211 Schedule C-2's proposes to deny Peoples Gas and North Shore recovery of \$2,615,000  
212 and \$282,000 of incentive compensation program expenses, respectively. What is your  
213 understanding of Mr. Effron's rationale for his proposed adjustments?

214 A. Mr. Effron states that it is his understanding that the Commission has generally  
215 disallowed recovery incentive compensation expenses except where the utility has  
216 demonstrated that the plan has reduced expenses and created greater efficiencies in  
217 operations, and he states that the Utilities have not proven that the plans here can  
218 reasonably be expected to do so.

219 Q. What is your understanding of the correctness of Mr. Effron's characterization of past  
220 Commission decisions?

221 A. The Utilities will address this subject in briefing, but it is my understanding that the  
222 Commission has allowed recovery of incentive compensation where there were other  
223 performance measures such as customer focus, diversity, and reliability. In any event, I  
224 believe that the Commission should approve all of the requested recovery of incentive  
225 compensation expenses, because they are prudent and reasonable. However, as I  
226 indicated above, in the alternative, I believe that the Commission should approve  
227 recovery of all of the requested “non-financial” expenses.

228 Q. Does this conclude your Rebuttal Testimony?

229 A. Yes.

**STATE OF ILLINOIS**  
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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

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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.

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<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.

**ICC Docket Nos. 07-0241 and 07-0242**  
**The Peoples Gas Light and Coke Company's and**  
**North Shore Gas Company's Response to**  
**Staff Data Requests BAP 15.01-15.03**  
**Dated: August 2, 2007**

**REQUEST NO. BAP 15.03:**

Referring to North Shore/Peoples Gas Ex. JCH 1.0, lines 80 through 83, in which Mr. Hoover describes the operational performance measure that was "25% weighting for controlling operations and maintenance expenses (excluding environmental costs recovered through Rider 11 and the provision for uncollectible accounts)":

- a) Identify the specific component of the TIA Plan (as previously provided as Appendix A in response to Staff Data Request BAP 10.01) that includes "controlling operations and maintenance expenses"; and
- b) Explain in detail, how "controlling operations and maintenance expenses" is determined as a criterion under the TIA award (i.e., how is this measured); and
- c) Provide supporting calculations that were used to determine that operations and maintenance expenses were controlled and the corresponding impact of this factor as a component of the TIA to which Mr. Hoover refers during the 2006 test year, and;
- d) Quantify the impact of "controlling operations and maintenance expenses" in terms of direct benefit to ratepayers.

**RESPONSE:**

- a) Controlling operations and maintenance expenses is included in the Gas Distribution – Responsibility Costs measure of the TIA Plan (BAP 10.01, Appendix A, p. 2 of 12).
- b) The Award is based on actual operation and maintenance costs for the Gas Distribution Segment as compared to predetermined targeted levels. The calculation includes all costs under the control of Peoples Gas and North Shore Gas excluding: environmental costs recovered through Rider 11; the provision for bad debt; and rate case expenses. See BAP 10.01, Appendix A, p. 2 of 12 for the target levels and payout related to this measure for the test year.
- c) See the attached schedule BAP 15.03c for calculations.
- d) Customers, in their rates, pay the Company's operations and maintenance expenses. To the extent that the Companies' employees are provided an incentive to reduce operations and maintenance expenses, the Companies will have lower revenue requirements to be recovered through rates than would otherwise be the

**ICC Docket Nos. 07-0241 and 07-0242**  
**The Peoples Gas Light and Coke Company's and**  
**North Shore Gas Company's Response to**  
**Staff Data Requests BAP 14.01-14.02**  
**Dated: June 18, 2007**

case. See the attached schedule BAP 15.03d for cost containment results from fiscal year 2001 through the test year.

The Peoples Gas Light and Coke Company  
North Shore Gas Company

NS-PGL Ex. JH/FV 2.1  
Page 3 of 4

**Fiscal 2006 STIC Funding Measures Controllable Gas Distribution Costs**

Target levels are based on budget and actual is compared to budget to determine payout percent achievement.

	<u>Actual 2006</u>	<u>Budget 2006</u>
<b>PGL</b>		
PGL Projects	400,637,512	330,265,025
Less PGL Officers & Administrative	184,305,093	79,654,387
Less Administration - Business Services	<u>42,700,341</u>	<u>61,699,199</u>
Subtotal PGL	173,632,078 <sup>1</sup>	188,911,439
Add back direct charges PGL/NSG President	900,223	921,908
<b>NSG</b>		
NSG Projects	31,596,187	30,662,235
Less NSG Officers & Administrative	<u>15,136,559</u>	<u>12,496,931</u>
Subtotal NSG	16,459,628 <sup>2</sup>	18,165,304
<b>Unusual Items</b>		
Add Gas Supply project	8,050,000	
Less Rate Case	2,010,000	
Total	<u><u>197,031,929</u></u>	<u><u>207,998,651</u></u>

**Total Peoples Gas Light**

Labor	93,232,924
Material	22,702,458
Outside Services	28,515,169
Other Costs	19,862,339
Redistribution	0
Direct Capital Purchases	5,264,348
Direct Bill Items	<u>4,054,840</u>
Total Costs	<u><u>173,632,078</u></u> <sup>1</sup>

**Total North Shore Gas**

Labor	11,564,096
Material	3,111,620
Outside Services	2,852,296
Other Costs	(1,729,940)
Redistribution	0
Direct Capital Purchases	661,556
Direct Bill Items	<u>0</u>
Total Costs	<u><u>16,459,628</u></u> <sup>2</sup>

Achievement

	Level 1 Target	Level 2 Target	Actual
Gas Distribution Costs (in millions)	188	198	197
Payout Percentage	200%	150%	155%

The Peoples Gas Light and Coke Company  
North Shore Gas Company

**Controllable Gas Distribution Costs (in millions)**

	Actual	Target	Percentage Savings
2006	\$197.0	\$208.0	5.29%
2005	178.6	193.0	7.46%
2004	207.9	210.0	1.00%
2003	205.2	203.0	-1.08%
2002	209.3	216.0	3.10%
2001	226.1	230.0	1.70%

2001 is the earliest comparison period available

**ICC Docket Nos. 07-0241 and 07-0242**  
**The Peoples Gas Light and Coke Company's and**  
**North Shore Gas Company's Response to**  
**Staff Data Request BAP 15.01-15.03**  
**Dated: August 2, 2007**

**REQUEST NO. BAP 15.01:**

Referring to North Shore/Peoples Gas Ex. JCH 1.0, lines 90 through 103, in which Mr. Hoover discusses the 2006 Individual Performance Bonus ("IPB") Plan, provide:

- a) For the last five fiscal years, the total dollar amount paid under the IPB Plan;
- b) For the last five fiscal years, a listing of recipients of IPBs that includes each employee's job title and the amount of annual bonus paid to each employee under the IPB Plan;
- c) Using the response to (b) for the most recent three years, ending with the 2006 test year, provide the specific criteria that formed the basis for the IPB of each individual; and,
- d) Using the response to (c), provide a detailed description of how these specific criteria directly benefited ratepayers.

**RESPONSE:**

- (a) IPB plan was only in place for 2006. In 2006, \$1,228,809 was paid, including the amounts paid to Peoples Gas and North Shore employees referenced on page 9 of the rebuttal testimony of Linda Kallas. See attached spreadsheet.
- (b) IPB plan was only in place for 2006. See attached spreadsheet for 2006 data.
- (c) IPB plan was only in place for 2006. In order to be eligible to receive an award under the Individual Performance Bonus (IPB) Plan, an employee needed to receive an above average performance evaluation of either Outstanding or Very Effective. In addition, the IPB guidelines recommended that no more than 33% of the employees receive an award.
- (d) As indicated in the response to subpart (c), there were no specific criteria forming the basis for the IPB of each of the over 400 employees receiving an IPB. Rather, the general criterion was to reward outstanding employees. Although the criteria for determining an outstanding employee can differ, in general these are employees who perform their assignments efficiently, understand the importance of providing quality service to customers (internal or external), know how to solve problems, and look for ways to do things better. Despite the absence of specific criteria, customers were benefited by the IPB because it is in the best interest of customers that the Companies' outstanding employees are compensated appropriately and provide incentives to do their best work. It is also in the best interest of the Companies'

**ICC Docket Nos. 07-0241 and 07-0242**  
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customers that its outstanding employees remain employed by the Companies and not seek work elsewhere. As pointed out by Mr. Hoover, on pages 3-4, lines 55 through 66 of his rebuttal testimony, incentive programs are designed to attract and retain a sufficient, qualified, and motivated work force. By doing so, the Companies make "sure that there are enough employees to perform needed work, by maintaining and improving the productivity and quality of work, and by reducing the expenses associated with recruiting and training new employees".