STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	No. 11-0280
Proposed general increase in rates for gas service.	:	
	:	(cons.)
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	
	:	No. 11-0281
Proposed general increase in rates for gas service.	:	

Surrebuttal Testimony of

NOREEN E. CLEARY
Assistant Vice President, Total Compensation -
Integrys Energy Group, Inc.

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

TABLE OF CONTENTS

I. INTRODUCTION AND BACKGROUND

A. Witness Identification

Q. Please state your name.

A. My name is Noreen E. Cleary.

Q. Are you the same Noreen E. Cleary who submitted rebuttal testimony on behalf of The Peoples Gas Light and Coke Company ("Peoples Gas") and North Shore Gas Company ("North Shore") (together, "the Utilities") in this proceeding?

A. Yes.

B. Purpose of Surrebuttal Testimony

Q. What is the purpose of your surrebuttal testimony in this proceeding?

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of Illinois Commerce Commission (the "Commission" or "ICC") Staff witness Theresa Ebrey and Illinois Attorney General/Citizens Utility Board/City of Chicago ("Governmental and Consumer Intervenors" or "GCI") witness David Effron related to Peoples Gas' and North Shore's incentive compensation plans. I also address Ms. Ebrey's proposed adjustments related to non-union base pay practices. Further, I respond to Staff witness Mike Ostrander's rebuttal testimony concerning a proposed disallowance of billed expenses from Integrys Business Support, LLC ("IBS") associated with the Utilities' Non-Executive Incentive Compensation Plans.

C. Summary of Conclusions

Q. Please summarize the conclusions of your surrebuttal testimony.

A. I conclude the following:

1. The Commission should reject Staff witness Ms. Ebrey's and GCI witness Mr. Effron's respective proposed adjustments to rate base and operating expenses for incentive compensation costs. Neither witness provided additional reasoning to support their proposed disallowances and they failed to rebut the support provided in direct and rebuttal testimony for the recovery of the Utilities' incentive compensation costs. These costs are prudent and reasonable and should be allowed.
2. The Commission should reject Staff witness Ms. Ebrey's proposed adjustments to rate base and operating expenses for non-union base wages. These costs are reasonable and should be allowed.
3. The Commission should reject Staff witness Mr. Ostrander's proposed disallowance of a portion of the billed expenses from IBS associated with the Non-Executive Incentive Compensation Plan.

D. Itemized Attachments to Testimony

Q. Are you sponsoring any exhibits?

A. Yes. I am sponsoring the following exhibits:

- NS-PGL Exhibit 43.1 – Response to Data Request NSPGL-Staff 12.10
- NS-PGL Exhibit 43.2 – Response to Data Request NSPGL-GCI 10.04

II. EXECUTIVE INCENTIVE COMPENSATION PLAN

Q. Staff witness Ms. Ebrey and GCI witness Mr. Effron maintain their positions on the disallowances they respectively proposed as to the Utilities' Executive Incentive Compensation Plan costs. (Ebrey Reb., Staff Ex. 12.0 Corrected, 6:106 – 8:147; Effron Reb., GCI Ex. 7.0, 10:223 – 11:231). What is your response?

A. The Commission should reject both Ms. Ebrey's and Mr. Effron's proposed adjustments to the Utilities' Executive Incentive Compensation Plan expenses as inappropriate and factually unsupported.

Q. How do you respond to Staff witness Ms. Ebrey's and GCI witness Mr. Effron's continued proposals for the Commission to disallow 70% of the Utilities' Executive Incentive Compensation Plan costs that is based on a calculated diluted earnings per share ("EPS") metric?

A. They contend that customers do not benefit from an EPS metric. Neither Ms. Ebrey nor Mr. Effron, however, relies upon any facts for this conclusion. Indeed, in response to data requests, both admitted that all else being equal, a utility that reduces its cost of service will increase its earnings per share. (*See* NS-PGL Ex. 43.1 (response of Ms. Ebrey to data request NSPGL-Staff 12.10); NS-PGL EX. 43.2 (response of Mr. Effron to NSPGL-GCI 10.04)) As I explained in my rebuttal testimony, it is an undeniable fact that EPS is derived from net income, so that everything else being equal, if a utility lowers its operating costs, it will have a higher EPS. Consequently, the EPS metric does provide significant incentive to the Utilities' executives to reduce operating costs, which directly benefits customers. While Ms. Ebrey attempts to marginalize it, the example I gave in my rebuttal testimony concerning executives foregoing their wage increases in an effort to reduce costs to increase EPS is a concrete example which demonstrates that this incentive does, in fact, work to the benefit of customers. Indeed, while Ms. Ebrey states that this example falls short because it had only a "de minimis" impact on the EPS metric and the incentive plan payout, she ignores that the *benefit* to ratepayers from this one action alone was a reduction in operating costs of $127,082. (*See* Ebrey Reb., Staff Ex.

12.0 Corrected, Attachment A (N) and (P) (response to data request showing the amount of foregone wage increases to executives was $127,082)) The evidence, therefore, compels the conclusion that the EPS metric does directly benefit customers and thus, the proposed disallowances of Ms. Ebrey and Mr. Effron should be rejected.

Q. Is your response similar to Ms. Ebrey's recommendation to disallow 50% of the remaining Executive Incentive Compensation Plan's expenses related to its non-financial performance metrics based on the fact that they would be reduced by half if the EPS threshold is not met. (*See* Ebrey Reb., Staff Ex. 12.0 Corrected, 8:136-142)?

A. Yes, this additional proposed disallowance recommended by Ms. Ebrey should be rejected for the same reasons.[1]

Q. How do you respond to Ms. Ebrey's rebuttal testimony on her proposed disallowance related to the non-financial performance metrics that include the results of Peoples Gas' and North Shore's affiliates?

A. The Commission should reject her proposed adjustments. Ms. Ebrey states she agrees that the costs of programs which benefit Illinois customers should be shared by those customers. Nevertheless, she concludes that the Utilities failed to demonstrate how Illinois customers benefit from the executive incentive compensation costs related to performance metrics inclusive of non-Illinois affiliates. (Ebrey Reb., Staff Ex. 12.0 Corrected, 7:119-133) Contrary to Ms. Ebrey's conclusion, however, my rebuttal testimony provided direct and concrete examples of how the costs for the sharing of best

[1] Ms. Ebrey does not appear to contest my testimony that the EPS target is likely to be met, but rather, bases this proposed disallowance on her general conclusion that EPS is an improper metric for recovery of incentive compensation. Accordingly, her proposal on this portion of the Executive Incentive Compensation Plan should be rejected for the same reasons I have demonstrated that an EPS metric will result in customer benefits.

practices at Integrys' corporate level related to the non-financial performance metrics of the Executive Incentive Compensation Plan directly benefit Illinois customers. For example, one of the non-financial performance metrics in the Executive Incentive Compensation Plan is OSHA-recordable incident rates. As I detailed in my rebuttal testimony (NS-PGL Ex. 25.0, 6:119-132), by having access to a specialized team of experts at the corporate Integrys level, Peoples Gas and North Shore dramatically improved their safety results with significant decreases in their OSHA-recordable rates between 2010 and 2011 to date. This demonstrates that the overall Integrys corporate response to the Executive Incentive Compensation Plan's safety metric directly resulted in benefits to Illinois customers.

I also described similar programs that will help Peoples Gas and North Shore improve customer satisfaction using J.D. Power methodologies and reduce environmental impacts by retaining environmental experts that are available to consult with each utility to help reduce emissions, which are related to the other two non-financial performance metrics in the Executive Incentive Compensation Plan. (*See* NS-PGL Ex. 25.0, 7:133-141) Again, this demonstrates how the corporate and Integrys affiliate-wide responses to the Executive Incentive Compensation Plan's non-financial performance metrics will lead to customer benefits *in Illinois.* The Commission, therefore, should allow full recovery of the costs related to these metrics.

III. NON-EXECUTIVE INCENTIVE COMPENSATION PLAN

Q. While Staff witness Ms. Ebrey agreed to drop her proposed disallowance for the expenses related to the non-financial metric portion of Peoples Gas' and North Shore's Non-Executive Incentive Compensation Plan, she continues to seek a disallowance equal to 50% of the plan's expenses and rate base that are associated with its Operation and Maintenance ("O&M") expense metric. (Ebrey Reb., Staff Ex. 12.0 Corrected, 8:149 – 11:190 and Schedules 12.2 P, page 3 and 12.2 N, page 3) What is your response to Ms. Ebrey's position on these expenses?

A. The Commission should reject Ms. Ebrey's proposal to disallow the Non-Executive Incentive Compensation Plan costs and rate base related to the O&M expense metric. Without further reasoning, Ms. Ebrey merely re-states her unsupported conclusion from her direct testimony that this metric, which rewards the reduction of O&M expenses, is merely another financial metric similar to the net income metric rejected by the Commission in the Utilities' previous rate cases. Ms. Ebrey ignores the numerous Commission decisions referenced in the Utilities' direct and rebuttal testimony in which the Commission specifically stated that an incentive compensation metric based on reducing O&M costs results in ratepayer benefits and thus is recoverable. (*See* PGL Ex. 9.0 at 10:174-194; NS Ex. 9.0 at 9:178 – 10:196; NS-PGL Ex. 25.0 at 10:206 – 12:248) In particular, Ms. Ebrey fails to acknowledge the Commission's specific conclusion in *In re Commonwealth Edison Co.*, ICC Docket No. 05-0597 (Order July 26, 2006) at 96, that: "Lowering O&M expenses, all else being equal, has the obvious effect of reducing the O&M expenses to be recovered in future rate cases." As in that proceeding, here, too, the Commission should approve recovery of costs related to an incentive compensation plan that encourages the reduction of O&M expenses.

Further, Ms. Ebrey critiques the Utilities' reliance on the Commission's decision in the most recent Commonwealth Edison Company ("ComEd") rate case[2] to approve 100% of the expenses for ComEd's incentive compensation plan that was based, in part, on an O&M expense metric. Ms. Ebrey asserts that this reliance is "invalid" because the Utilities did not consider the fact that the Commission also disallowed 100% of ComEd's Stock Award Program. (Ebrey Reb., Staff Ex. 12.0 Corrected, 9:155-160) Ms. Ebrey, however, does not explain why the Commission's decision in *ComEd 2010* on ComEd's incentive compensation plan had any relation to its decision as to that company's Stock Award Program. The reason is that there is *no* relation between the two; the Commission made its determinations as to these two distinct plans based on the facts presented for each of those plans. While the Commission concluded that the costs for the incentive compensation plan were recoverable because, like the Utilities' plans at issue here, it was designed to benefit ratepayers, the Commission determined that ComEd had failed to prove that the Stock Award Plan would provide similar benefits to ratepayers. *ComEd 2010* at 65. Moreover, Ms. Ebrey's argument on this point makes no sense here because she also is recommending that the Commission disallow 100% of the Utilities' stock plans as well which, if accepted, would make the present case exactly similar to *ComEd 2010*.

Q. What is your response to Ms. Ebrey's continued position that the O&M expense metric also is improper because its target is based on the Utilities' 2012 future test year O&M budget?

[2] *In re Commonwealth Edison Co.*, ICC Docket No. 10-0467 (Order May 24, 2011) at 60-65 ("*ComEd 2010*").

A. Ms. Ebrey merely continues to refer to the conclusion she asserted in her direct testimony that the metric is improper because the Commission critiqued the use of budget targets in ComEd's alternative rate regulation plan proceeding, *In re Commonwealth Edison Co.*, ICC Docket No. 10-0527 (Order May 24, 2011) ("*ComEd Alt. Reg.*"). She does not address the distinctions I made in my rebuttal testimony between a base rate case such as the current proceeding and the particular circumstances of the *ComEd Alt. Reg.* case. (*See* NS-PGL Ex. 25.0, 12:239 – 13:263) Thus, Ms. Ebrey's unsupported conclusion fails to recognize the fact that the budget at issue here is being subjected to the full scrutiny of a base rate proceeding, whereas in the ComEd alternative rate regulation case, the Commission's concern with the use of budgets was one of insufficient "transparency." *ComEd Alt. Reg.* at 19. Furthermore, Ms. Ebrey ignored the numerous Commission decisions discussed in my rebuttal testimony in which the Commission approved recovery of incentive compensation expenses related to a metric based upon a utility's budget. (*See* NS-PGL Ex. 25.0, 11:221 – 12:238) The fact is that Ms. Ebrey's position is unsupported and the Commission should approve recovery of the Utilities' Non-Executive Incentive Compensation Plan costs related to the O&M expense metric.

Q. **What is your understanding of Ms. Ebrey's position concerning your alternative proposal with respect to the recovery of costs related to the Non-Executive Incentive Compensation Plan's O&M metric vis-à-vis affiliate-performance goals?**

A. In her direct testimony, Ms. Ebrey appeared to be arguing that the non-executive incentive compensation costs based upon the O&M expense metric also should be disallowed because that metric is calculated on a combined utility basis which includes amounts for affiliates operating outside of Illinois. (Ebrey Dir., Staff Ex. 3.0, 13:259-

265) In my rebuttal testimony, I explained that if the Commission agrees with the Utilities and rejects Ms. Ebrey's proposed disallowance based on her arguments that the O&M metric was an improper financial metric or budget-based target, but did agree with Ms. Ebrey on her non-Illinois affiliate argument, that this still would not be grounds for disallowing all of the costs associated with the O&M metric. Rather, if the Commission were to disallow any costs based on the inclusion of non-Illinois affiliates in the O&M expense metric, then only that portion of those costs attributable to the non-Illinois affiliates should be disallowed. (*See* NS-PGL Ex. 25.0, 13:278 – 14:297) As I explained, this would be consistent with Ms. Ebrey's own approach with respect to the non-financial performance metrics in the Utilities' Executive Incentive Compensation Plan.

In her rebuttal testimony, Ms. Ebrey replies to this alternate proposal by referring back to her position that all of the costs associated with the O&M metric should be disallowed because of her conclusion that it is an improper financial metric. (Ebrey Reb., Staff Ex. 12.0 Corrected, 10:172-180) This reply, however, does not address the position stated in my rebuttal testimony as to what should happen if the Commission accepts Ms. Ebrey's non-Illinois affiliate argument but rejects Ms. Ebrey's other arguments concerning the O&M metric. While the Utilities continue to maintain that all of the incentive compensation expenses related to this O&M metric are recoverable, if the Commission determines that some disallowance is required only due to the inclusion of non-Illinois affiliates, then that disallowance should be made on the alternative basis set forth in my rebuttal testimony.

Q. What is your response to Staff witness Mr. Ostrander's proposal for an additional disallowance for a portion of the billed expenses from IBS associated with the Non-

Executive Compensation Plan? (Ostrander Reb., Staff Ex. 11.0 Corrected, 6:121 – 7:135)?

A. The Commission should reject this disallowance proposed by Mr. Ostrander. Mr. Ostrander merely relies upon the arguments made by Ms. Ebrey to apply the same disallowance percentage proposed by Ms. Ebrey for the Non-Executive Compensation Plan expenses to the portion of IBS goal sharing costs that are attributable to payments of incentive compensation under that plan to IBS employees. (*See* Staff Exs. 11.1 N (Confidential) Corrected, Page 3 and 11.1 P (Confidential) Corrected, Page 3) Accordingly, the Commission should reject this proposed disallowance for the same reasons explained above and in my rebuttal testimony for rejecting Ms. Ebrey's proposed 50% disallowance of the Utilities' Non-Executive Incentive Compensation Plan expenses. As I have demonstrated, the plan's O&M expense metric provides direct benefits to customers and has been held by the Commission to be an appropriate basis for incentive compensation recovery.

IV. OMNIBUS INCENTIVE COMPENSATION PLAN

Q. What is your response to Staff witness Ms. Ebrey's continued proposal for the disallowance of the Utilities' expenses related to Omnibus Incentive Compensation Plan? (Ebrey Reb., Staff Ex. 12.0 Corrected, 11:191–203)

A. Ms. Ebrey raises no new arguments for the disallowance of these expenses, and thus, her proposed disallowances should be rejected for the same reasons as I stated in my rebuttal testimony. (NS-PGL Ex. 25.0, 16:343 – 17:360)

V. <u>PROPOSED ADJUSTMENTS TO NON-UNION BASE WAGE INCREASES</u>

Q. For purposes of adjusting the Utilities' non-union base wage increases, Staff witness Ms. Ebrey applies a 3.0% increase to determine the 2011 level of wages rather than the 3.9% used by the Utilities. (Ebrey Reb., Staff Ex. 12.0 Corrected, 14:257 – 15:264) Do you agree with this approach?

A. No, I do not. First, 3.9% is the actual amount by which the Utilities' non-union base wage expenses actually will have increased between 2010 and 2011. The Utilities have applied a 3.0% general wage increase to their non-union employees for 2011, and have used the pool of funds equal to .3% of base wages to provide additional merit increases to high-performing employees. Additionally, at this time, all but 38% of the pool of funds created to pay the increase in salaries corresponding to promotions (the .6% pool of funds) has actually been used, and the remaining amount will be applied in October 2011. Accordingly, using a 3.0% increase for 2011 will not accurately portray the reality of the increases to the Utilities' non-union base wages.

Furthermore, while Ms. Ebrey relies upon the World at Work Survey to argue that "[o]nly the highest performers could expect increases as high as 4%" to support her proposed reduction (Ebrey Reb., Staff Ex. 12.0 Corrected, 14:247-250), this statement ignores the fact that the .3% and .6% pool of funds were used to provide raises to the Utilities' highest performers – those deserving of an additional merit-based wage increase and/or a promotion. Moreover, reliance upon the World at Work surveys concerning general wage level increases or the general inflation rate shown by the *Survey of Professional Forecasters* ("*Survey*") for purposes of analyzing the .6% pool of funds is completely misplaced. These funds were used to provide salary increases corresponding to employee promotions, *i.e.*, a change in an employee's relative position within the company based on the going market based rate of pay for that new elevated position, not a general inflationary or cost of living increase. Accordingly, Ms. Ebrey's adjustments should be rejected for these reasons, as well.

Q. Ms. Ebrey then applies a 2.30% increase for the 2012 test year rather than the 3.9% increase actually planned and budgeted for by the Utilities based upon a forecasted 2.30% Consumer Price Index ("CPI") general inflation rate for the 2011-2015 period. (Ebrey Reb., Staff Ex. 12.0 Corrected, 15:265 – 16:281) Do you agree with Ms. Ebrey's adjustment?

A. No, I do not. As I explained in my rebuttal testimony (NS-PGL Ex. 25.0, 19:419 – 20:436), the CPI is an economic indicator that measures a change over time in the prices paid by consumers for a market basket of goods and is *not* intended to be a measure that is directly related to or predictive of changes in employee wages. Also, as pointed out in my rebuttal testimony, the CPI does not take into account the differences between wages in various industries versus overall average wage levels, as shown by the Bureau of Labor Statistics' Employment Cost Index. *Id*. In the Employment Cost Index for June 2011, the level of wage increases for workers in the utility industry for the 12 months ended June 2011 was 3.0%, versus 1.7% for all workers in private industry generally.[3] Indeed, this shows a widening gap between wage increases in the utility industry and private industry generally, as the difference between the two grew from 1.0% to 1.3%

[3] *See* Bureau of Labor Statistics July 29, 2011 News Release at p.7 (available at the Bureau of Labor Statistics' website – http://www.bls.gov/news.release/pdf/eci.pdf).

from the 12 months ended March 2011.[4] Thus, the forecasted general rate of inflation reflected in CPI during the 2011-2015 period contained in the *Survey* is not applicable to the issue of determining how non-union base wages should be set for the Utilities' 2012 test year.

Also, Ms. Ebrey's rationale for departing from the wage specific forecast for 2011-2012 provided by the World at Work survey, which projects a general 2.9% increase in wages for 2012, in favor of the forecasted level of general inflation for 2011 to 2015 represented by the CPI prediction in the *Survey* is unsupported, speculative and improper. In addition to the problems of using CPI to address the issue of wage increase discussed above, Ms. Ebrey's reliance on her assumption that the 2011-2015 period would be "more in line with the period that rates set in this proceeding will be in effect" is not only speculative (*e.g.*, there have been only 2 years between the Utilities' last rate case and this one), but also looks outside the 12-month period being examined for the purposes of setting the Utilities' base rates. This is not a proper basis for departing from the wage specific forecasts provided by the World at Work surveys for 2011 and 2012. Thus, Ms. Ebrey's adjustments to the increase in non-union base wages for the 2012 test year should be rejected.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

---

[4] While Ms. Ebrey critiques the Utilities' reliance upon the Employment Cost Index because it is based on actual historical data rather than predictions for the future (*see* Ebrey Reb., Staff Ex. 12.0 Corrected, 16:278-280), this misses the point. I do not refer to the Employment Cost Index as a prediction for future wage increases, but rather, to demonstrate that the general rate of inflation represented by CPI is not relevant to the issue of wage increases and to show that there is an actual difference between the level of wage increases generally and the utility industry in particular, a difference that actual data demonstrates is trending towards widening.