ComEd Ex. 18.0

# STATE OF ILLINOIS

# ILLINOIS COMMERCE COMMISSION

| | | |
|---|---|---|
| COMMONWEALTH EDISON COMPANY | : | |
| | : | No. 14-0312 |
| Annual formula rate update and | : | |
| revenue requirement reconciliation | : | |
| under Section 16-108.5 of the Public | : | |
| Utilities Act | : | |

Rebuttal Testimony of

**GARY PRESCOTT**

Vice President
Corporate Compensation

on behalf of

Commonwealth Edison Company

# TABLE OF CONTENTS

**Section** **Page**

# I. INTRODUCTION

## A. Witness Identification

Q. **What is your name and business address?**

A. My name is Gary Prescott. My business address is 10 S. Dearborn, 50th Floor, Chicago, Illinois 60603.

Q. **By whom and in what position are you employed?**

A. I am employed by Exelon Business Services Company ("Exelon BSC") in the position of Vice President, Corporate Compensation.

## B. Summary of Rebuttal Testimony

Q. **What is the purpose of your rebuttal testimony?**

A. I respond to the Illinois Attorney General ("AG") witness Mr. Brosch and the City of Chicago, Citizens Utility Board, and Illinois Industrial Energy Consumers (collectively "CCI") witness Mr. Gorman's proposed disallowances regarding certain Commonwealth Edison Company ("ComEd") compensation plans. Specifically, I address their misconceptions regarding ComEd's Annual Incentive Program ("AIP") and ComEd's Key Manager Long Term Performance Program ("LTPP").

Q. **Please summarize the conclusions you reach.**

A. There is no basis for the Illinois Commerce Commission ("Commission") to grant the Intervenors' proposed disallowance of ComEd's incentive compensation expenses. ComEd's AIP expense is not based on the earnings per share ("EPS") of Exelon or of any affiliate. By design, ComEd can never pay out AIP that is earned on, tied to, or based on EPS. ComEd's AIP is based on its employees meeting stringent operational metrics, which are expressly set forth in the formula rate statute. There is a limiter feature that may apply to reduce (never increase) awards, and in extreme cases the limiter can reduce awards to zero. Mr. Brosch asserts that because this limiter can influence incentive compensation payout (only downward), the AIP is "based on" EPS. He is wrong. ComEd's AIP carefully tracks the statutory requirements and complies with recent Commission orders.

Similarly, ComEd's LTPP is not based on the EPS of Exelon or any of its affiliates. Like its AIP, ComEd's LTPP is based on employees meeting stringent operational metrics. Unlike the AIP, the LTPP covers key, executive-track employees and involves awards that vest over a three-year period. The LTPP, therefore, is designed to develop and retain exceptionally talented employees, which also benefits customers.

### C. <u>Qualifications and Professional Background</u>

Q. **What are your duties and responsibilities as Vice President, Corporate Compensation?**

A. As Vice President, Corporate Compensation, I have executive responsibility for oversight of Exelon's Corporate Compensation function including design, communication, legal and regulatory documentation, and administration of compensation plans for all of the operating companies, including ComEd.

Q. **Prior to your current position, what other positions did you hold at ComEd and its affiliates?**

A. I joined Unicom Corporation in 1996 and held positions of increasing responsibility from Senior Compensation Consultant to Director, Compensation, before being appointed Vice President, Corporate Compensation in March 2012.

Q. **What was your professional experience prior to assuming your duties with ComEd and its affiliates?**

A. Previously I held positions in Compensation and Human Resources at several large employers within the Chicago area for a total of 10 years.

Q. **What is your educational background?**

A. My educational background includes a B.A. in Industrial/Organizational Psychology from the University of Illinois in Urbana, Illinois and an M.B.A. in Human Resources Management from DePaul University in Chicago, Illinois.

Q. **Do you hold any professional certifications or memberships?**

A. Yes. I am a Certified Compensation Professional ("CCP") and member of the WorldatWork, a professional society dedicated to compensation and benefits program design, and to the development of compensation professionals. I am also a member of the Chicago Compensation Association Senior Executive Compensation group, which comprises the compensation leaders of the largest Chicago Metropolitan companies.

## II. COMED'S COMPENSATION STRUCTURE

**Q. Can you explain the basic premise behind the ComEd compensation structure?**

A. Yes. ComEd sets total compensation at levels that allow it to remain competitive with comparable companies. This allows ComEd to compete in the marketplace to attract and retain qualified personnel.

**Q. How does incentive compensation fit into this structure?**

A. Like many other companies, instead of providing employees with the totality of their compensation in the form of fixed compensation, ComEd utilizes incentive compensation or "pay at risk" – I will use these terms interchangeably throughout my testimony – to manage a portion of employees' pay.

**Q. How does ComEd utilize pay at risk?**

A. ComEd makes a portion of its employees' total compensation contingent upon achievement of operational metrics specified in the applicable incentive compensation plans. The selected metrics are those that are critical to running ComEd's business reliably, efficiently, and safely, and keeping ComEd's commitments to its customers. The portion of compensation that is at risk increases as an employee's level of responsibility increases.

**Q. What is the result of utilizing pay at risk instead of providing employees with the totality of their compensation in the form of fixed compensation?**

A. Pay at risk directly ties compensation to performance – if employees want to earn market-level compensation, they need to ensure that ComEd meets its operational metrics.

Q. **What happens if ComEd employees do not meet the operational metrics in the applicable incentive compensation plans?**

A. As I mentioned above, those employees will not receive the portion of their pay that was "at risk." As a result, when customers do not receive the benefits of those metrics, lower compensation costs are passed on to customers. This cost savings is made possible because the incentive compensation portion of total compensation is a portion of what costs would be without "pay at risk." In other words, if ComEd replaced "pay at risk" with higher base salaries, delivery service rates would be based on those higher salaries with or without performance.

Q. **Is incentive compensation or pay at risk the only possible way for ComEd to structure its compensation and remain competitive in the marketplace?**

A. No. ComEd could simply provide all compensation in the form of fixed compensation, *i.e.* increase base salary. ComEd believes that this would be an inferior approach, however, because it does not to the same degree incent employees to meet and exceed operational goals that ultimately benefit customers.

Q. **Is the incentive compensation method superior?**

A. Yes. The incentive compensation method is superior because it provides more value to ComEd and its customers by ensuring that employees must meet and exceed certain operational goals before they receive their total compensation. Incentive compensation also improves productivity and performance and increases customer benefits.

Q. **Does utilizing incentive compensation increase costs for ComEd's customers?**

A. No. To the contrary, it controls and even decreases costs in the long run. This is because higher levels of fixed compensation also increase fixed costs over time, which is a more costly approach in the long run. Stated another way, while base salaries are generally guaranteed in future years – they are fixed costs – incentive compensation is not guaranteed – metrics must be met by employees each year in order to earn the incentives available in that year. And to the extent the incentive compensation improves productivity and performance, it decreases operational costs.

Q. **How does ComEd know that the "pay at risk" concept actually works?**

A. The "pay at risk" concept has been widely researched over many years, and is based on behavioral psychology principles of reinforcement. Studies generate differing results, but generally, they tend to show that incentives increase productivity and performance by 20 to 25% or more. When the goals are carefully selected, objectively measured, appropriately communicated, and obtainable, results can be even better.

Q. **Does ComEd have any specific evidence of this?**

A. Yes. As illustrated in the Rebuttal Testimony of ComEd witness Mr. Kevin Brookins, ComEd Ex. 19.0, ComEd has experienced significant improvement in achieving or exceeding its operational metrics over the past four years, which we believe is directly influenced by the company's incentive compensation program. Indeed, since 2011, ComEd has moved into first quartile rankings among its peer investor owned utilities in several operational categories.

## III. COMED'S INCENTIVE COMPENSATION PLANS

Q. **What are the incentive compensation plans that you address?**

A. I address Staff and Intervenor proposals to disallow recovery of expenses related to the AIP and LTPP.

**A. <u>AIP</u>**

Q. **As a preliminary matter, what is the Exelon Corporation Annual Incentive Program ("Exelon AIP")?**

A. The Exelon AIP serves as the "umbrella" structure for each of the Operating Company (as defined in the Exelon AIP) incentive plans, in order to provide consistent structure and administration of the plans.

Q. **How does this umbrella structure work?**

A. Each Operating Company has its own <u>separate</u> AIP, including ComEd. Each Operating Company has goals that are specifically relevant to each entity, such as the customer-focused metrics for ComEd. And there is no overlap in participation between the various Operating Company plans – employees can only participate in one AIP.

Q. **Who participates in ComEd's AIP?**

A. All of ComEd's approximately 6,000 employees participate in ComEd's AIP. This means that every ComEd employee has a portion of their total compensation contingent upon achievement of operational metrics.

Q. **Does that figure include International Brotherhood of Electrical Workers ("IBEW") union employees?**

A. Yes. This includes the almost 3,700 represented employees, each of whom has a portion of his or her total compensation "at risk" and contingent upon achievement of operational metrics.

Q. **Mr. Brosch claims that the two plans – Exelon AIP and ComEd AIP – are one and the same. Is that accurate?**

A. No. They are separate plans. Mr. Brosch's incorrect statements in this regard are based on ComEd's Response to Staff Data Request RWB 7.01. That data request asked for documents associated with the shareholder protection feature, also known as the SPF, which is simply a limiter to all of the Operating Companies' AIP awards. *See* AG Ex. 1.7. This limiter is described within the Exelon AIP, not the ComEd AIP, thus ComEd provided the AG with the Exelon AIP plan documentation. This does not make the plans "the same thing" as he claims. (Brosch Dir., AG Ex. 1.0C, 20:446-456).

Q. **Can you explain the limiter that you referred to earlier?**

A. Yes. The Exelon AIP puts in overall limitations on payouts of all of the Operating Companies' AIP awards. A limiter of this type is a standard feature in good incentive plan design.

Q. **How does the limiter function?**

A. ComEd employees earn AIP awards solely by meeting operational metrics. These are also referred to as funding Key Performance Indicators ("KPIs") or business unit goals. After those awards are earned, the payout can only be <u>reduced</u> by the limiter.

Q. **How is the limiter calculated?**

A. The limiter is calculated by determining the percentage achievement of the target earnings per share ("EPS") of Exelon Corporation ("Exelon") plus 20 percentage points. By way of example, in 2013, the limiter was calculated as follows: Exelon's EPS was 104.4% of target. Adding 20 percentage points to that figure results in a payout limit of 124.4%. Thus, even though ComEd's performance relative to its KPIs would have resulted in a payout of 140.4%, the payout was limited to 124.4%.

Q. **How does this limiter impact ComEd's customers?**

A. Since the limiter only modifies awards negatively, not having this feature in place would often result in higher awards. In short, because of the limiter, ComEd's customers are often able to enjoy a higher level of performance for less money. In this respect, the limiter really functions as a customer protection feature.

Q. **Are ComEd AIP awards based on the limiter?**

A. No. They are not based on the limiter. The limiter does not fund ComEd's AIP awards. The limiter cannot determine or increase awards pursuant to the ComEd AIP – it can only limit, or reduce them.

Q. **Is the AIP awarded to ComEd employees based on an affiliate's EPS?**

A. No. ComEd's current AIP is based solely on achievement of operational metrics and not on an affiliate's EPS.

Q. **Has ComEd's AIP ever been based on an affiliate's EPS?**

A. Yes. In the past, ComEd's AIP was based in part on EPS. For example, in 2005 ComEd's AIP included four funding measures, one of which was EPS. In ComEd's rate case that year, the Commission disallowed recovery of 50% of ComEd's AIP – the portion that was based on EPS.

Q. **Has ComEd's AIP ever been based on net income?**

A. Yes. In the past, ComEd's AIP was based in part on net income. For example, in 2007 ComEd's AIP included a net income metric. In ComEd's rate case that year, the Commission disallowed recovery of the portion of ComEd's AIP that was based on the net income goal.

Q. **How did ComEd respond to the Commission orders disallowing a portion of the compensation?**

A. In compliance with the Commission's orders, ComEd removed EPS and net income as funding mechanisms for its AIP. And in ComEd's 2010 rate case the Commission allowed 100% recovery of ComEd's AIP expenses.

Q. **Is the current AIP substantially similar to the AIP that was effective in 2010?**

A. Yes. The current AIP is substantially similar to the 2010 AIP. Specifically, awards pursuant to the 2010 AIP were determined using operational metrics and were then subject to a net income limiter.

Q. **Has ComEd ever used net income or an affiliate's EPS as an AIP limiter before?**

A. Yes. Since at least 2010 ComEd's AIP has utilized net income or affiliate's EPS as a limiter.

Q. **How long has the limiter at issue in this docket been in place?**

A. The current limiter has been applicable to ComEd's AIP since 2012.

Q. **Are other Operating Companies' AIP awards currently based on EPS of an affiliate?**

A. Yes. Exelon BSC's AIP is clearly based in part on an affiliate's EPS. Exelon BSC's funding mechanism – its KPIs – is comprised of both Exelon EPS (weighted 75%) and operational business unit goals (weighted 25%). The Commission recognized this in Docket No. 11-0721 and disallowed only that the portion of Exelon BSC's AIP that was based on affiliate's EPS, *i.e.* the funding mechanisms based on affiliate's EPS.

Q. **Has ComEd sought recovery of the portion of BSC's AIP based on EPS?**

A. No. In accordance with the Commission order in Docket No. 11-0721, ComEd has removed that portion of AIP from the revenue requirement.

Q. **Under the current AIP, will ComEd's customers pay for an award that is based on the EPS of an affiliate?**

A. No. Even when ComEd employees meet or exceed all the goals related to metrics that benefit customers, as they have done over the past few years, the limiter nonetheless reduces the payout under the AIP, and it will never increase the payout.

Q. **Have ComEd's customers tangibly benefited from the limiter since it has been in place?**

A. Yes. Since 2012, ComEd's customers would have paid approximately $25.5 million more in incentive compensation without the limiter. It is incomprehensible why any Intervenor would seek to disallow costs due to ComEd's utilization of the limiter.

Q. **How do you calculate that ComEd's customers have saved over $25 million as a result of the limiter?**

A. The limiter reduced ComEd's AIP award in 2013 by approximately $8.5 million. (Brinkman Dir., ComEd Ex. 2.0, 23:470-475). Likewise, in 2012, the limiter reduced ComEd's AIP award by approximately $17 million. While there were other ratemaking adjustments to the 2012 figures that ultimately lowered the recoverable amount, before ratemaking adjustments those figures nonetheless add up to $25.5 million.

Q. **Mr. Brosch also states that the limiter has a threshold EPS requirement before ComEd employees are eligible to receive awards pursuant to ComEd's AIP. Does this change your analysis?**

A. No. This does not change my analysis. It is not a metric on which the awards are based. The calculation of the awards remains entirely separate from EPS. Mr. Brosch himself admits that "ComEd and BGE KPIs do not directly incorporate Exelon EPS as a Funding KPI." *See* ComEd-AG 2.05(a), attached hereto as ComEd Ex. 18.01. Awards are calculated based on ComEd operational KPIs, and then they may be limited, or in extreme circumstances reduced to zero, by the limiting feature.

**B. <u>LTPP</u>**

Q. **What is ComEd's LTPP?**

A. ComEd's LTPP is a long-term incentive compensation plan applicable to "key managers," or those employees who have significant areas of responsibility and impact within ComEd and whose jobs would typically receive long-term incentives as a part of their compensation package at comparable companies.

Q. **What makes the LTPP long term?**

A. The LTPP award vests over three years, as opposed to an immediate cash award under the AIP. This vesting period is designed to incent employees to stay with ComEd, optimizing ComEd's investment in training and development of its key talent. A three-year vesting period is typical for long-term incentive programs.

Q. **Why is it important to retain the group of employees that are eligible to participate in the LTPP?**

A. The employees eligible for LTPP are subject matter experts and managers today and the potential ComEd executives of tomorrow. It is extremely important for ComEd and its customers to develop and retain these employees.

Q. **Why is it so important that ComEd develop and retain these employees?**

A. Due to the complexities and time intensive nature of our business and the advanced technical capabilities required, it is very difficult to find qualified talent at executive levels. Thus, using long-term incentive compensation as a tool, ComEd invests in building talent from within where possible.

Q. **Has this investment been fruitful?**

A. Yes. During 2013 for example, ComEd was successful in retaining 100% of its high potential Key Managers and executives, those being groomed for higher level roles, while the utility industry benchmark was 97.3%.

Q. **Mr. Gorman recommends disallowing all costs associated with the LTPP because he claims the performance goals, definitions, and metrics mirror those of the AIP and therefore the LTPP is essentially duplicative. How do you respond?**

A. Mr. Gorman is correct that the performance goals, definitions, and metrics of the LTPP mirror those of the AIP. This is simply due to the fact that the plan was designed based on feedback from stakeholders (*e.g.*, the Commission) that our long-term incentive programs should include performance goals that benefit customers. Since the AIP includes the goals that are most critical to ComEd's business, those goals are also used in this plan to ensure our key managers retain focus on them.

Q. **Does that make the LTPP duplicative?**

A. No. The AIP is a short-term incentive plan and the LTPP is a long-term incentive plan. The AIP and the LTPP work together, with different eligibility requirements and vesting periods but identical performance goals, definitions, and metrics and are part of a total compensation package at market levels. Stated another way, the AIP is designed to immediately compensate all ComEd employees for high levels of performance that benefit customers. In contrast, the LTPP is designed to defer compensation for certain employees with the goal of retaining those employees for the long-term.

## IV. CONCLUSION

Q. **Does this conclude your rebuttal testimony?**

A. Yes.