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Case No.: WR-2015-0301
SR-2015-0302
Date: July 31, 2015

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2015-0301
CASE NO. SR-2015-0302**

DIRECT TESTIMONY

OF

ROBERT V. MUSTICH

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

IN THE MATTER OF MISSOURI-AMERICAN) WATER COMPANY FOR AUTHORITY TO) FILE TARIFFS REFLECTING INCREASED) RATES FOR WATER AND SEWER) SERVICE)	CASE NO. WR-2015-0301 CASE NO. SR-2015-0302
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AFFIDAVIT OF ROBERT V. MUSTICH

Robert V. Mustich, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Direct Testimony of Robert V. Mustich"; that said testimony and schedules were prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge.



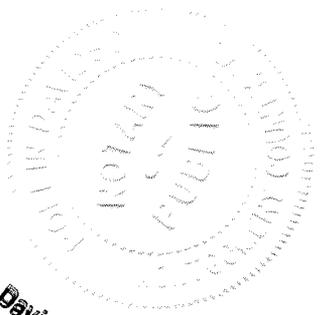
Robert V. Mustich

State of Maryland
County of Montgomery
SUBSCRIBED and sworn to
Before me this 28th day of July 2015.



Notary Public

My commission expires: 6/21/2016


**Reilin Davidson
Notary Public
Montgomery County
Maryland
My Commission Expires 06-21-2016**

**DIRECT TESTIMONY
ROBERT V. MUSTICH
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2015-0301
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DIRECT TESTIMONY
ROBERT V. MUSTICH

I. INTRODUCTION

Q1. PLEASE PROVIDE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A1. My name is Robert V. Mustich. I am Managing Director and the U.S. East Division Practice Leader, Executive Compensation for Towers Watson. Towers Watson is a leading global professional services company, which has 14,000 associates throughout the world, and offers solutions in the areas of employee benefits, talent management, rewards and risk, and capital management. My business address is 901 North Glebe Road, Arlington, VA 22203.

Q2. PLEASE EXPLAIN TOWERS WATSON’S EXPERIENCE IN PROVIDING COMPENSATION AND BENEFITS CONSULTING SERVICES TO ORGANIZATIONS LIKE MISSOURI-AMERICAN WATER COMPANY (“MISSOURI-AMERICAN WATER”)?

A2. Towers Watson has extensive experience serving clients in the utility industry, having served approximately 100 utilities in the U.S. within the last year. Because we invest heavily in our utility industry capabilities, we have rich competitive industry compensation and benefits information that enables Missouri-American Water to benchmark against similar companies in the U.S. Given Towers Watson’s breadth and depth of resources, we are frequently engaged by companies to evaluate the competitiveness of their compensation philosophy, compensation and benefit levels, at-risk compensation design and pay structures and other consulting services.

1 Q3. PLEASE STATE YOUR EDUCATIONAL AND PROFESSIONAL
2 BACKGROUND AND EXPERIENCE.

3 A3. I graduated from American University with a BS/BA in Human Resources Management.
4 I have over 25 years of industry and compensation consulting services experience, have
5 been with Towers Watson for over 17 years, and have assisted management and Boards
6 of Directors at numerous companies in designing and assessing total compensation
7 programs. Since joining the firm in 1997, I have consulted with numerous utilities and
8 currently serve as U.S. East Division Executive Compensation Practice Leader in
9 addition to being a senior member of our utilities industry practice. I have conducted
10 competitive assessments of total compensation for numerous public utilities throughout
11 the U.S. Prior to joining Towers Watson, I was a senior compensation consultant for
12 PricewaterhouseCoopers (formally Coopers and Lybrand, LLP) performing similar
13 compensation consulting services for clients. Prior to that, I held corporate senior staff
14 compensation and benefits positions.

15 II. PURPOSE OF TESTIMONY

16
17 Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

18 A4. The purpose of my testimony is to demonstrate that the target total direct compensation
19 provided to Missouri-American Water short-term at-risk compensation eligible
20 employees, when viewed against the markets for talent for employees in similar
21 positions, is at the low end or below the competitive range of the market based on the
22 company's stated compensation philosophy. Towers Watson specifically focused on the
23 following aspects of Missouri-American Water's program:

- 24
- Total compensation philosophy;
 - Competitive market positioning of target total direct compensation (base salary plus
- 25

1 short-term at-risk compensation plus long-term at-risk compensation);

- 2 • Design of short-term at-risk compensation program; and
- 3 • Design of long-term at-risk compensation program.

4

5 **Q5. HAVE TOWERS WATSON AND YOU PERFORMED SIMILAR ANALYSES IN**
6 **THE PAST?**

7 A5. Yes. Towers Watson and I have conducted similar competitive compensation studies for
8 other utility clients.

9 **III. OVERVIEW OF TOTAL COMPENSATION PHILOSOPHY**

10

11 **Q6. DOES MISSOURI-AMERICAN WATER HAVE A DEFINED COMPENSATION**
12 **PHILOSOPHY?**

13 A6. Yes, American Water Works Company, Inc. (American Water), has a defined
14 compensation philosophy which is applicable to Missouri-American Water.

15 **Q7. HOW WOULD YOU DEFINE AMERICAN WATER'S COMPENSATION**
16 **PHILOSOPHY?**

17 A7. American Water's compensation philosophy is to generally pay salaries that are
18 competitive with those of comparable organizations for jobs of similar responsibility. To
19 carry out this philosophy, American Water's objective is to target total direct
20 compensation (base, short-term at-risk compensation, and long-term at-risk
21 compensation) at the median (50th percentile) of the market with greater earning
22 opportunity for exceptional performance for fully qualified individuals.

23 **Q8. HOW DOES THIS COMPENSATION PHILOSOPHY COMPARE WITH OTHER**
24 **UTILITIES?**

1 A8. Towers Watson examined the proxy statements for two peer groups: (1) Large Utility Peer
2 Group, 16 publicly-traded utilities comparable in size to American Water (revenues range
3 from ½ to 2.5 times American Water’s 2014 revenues of \$3.0 billion), as disclosed in the
4 company’s March 26, 2015 proxy statement, and (2) Small Utility Peer Group, 13
5 publicly-traded utilities comparable in size to Missouri-American Water (revenues range
6 from \$46-\$780M, compared to Missouri-American Water’s forecasted 2015 revenue of
7 \$279M). Based on our review, we believe American Water’s compensation philosophy is
8 well-aligned with utility peers, as a majority of both Large Utility Peer Group companies
9 (15 of 16, 94%) and Small Utility Peer Group companies (7 of 13, 54%) target the market
10 median (50th percentile) for some or all pay elements. Our consulting experience also
11 suggests that American Water’s median (50th percentile) pay philosophy is comparable to
12 typical market practice found in general industry.

13 **IV. SUMMARY OF TOWERS WATSON’S TOTAL COMPENSATION STUDY**

14 **Q9. DID YOU CONDUCT A COMPENSATION STUDY OF MISSOURI-AMERICAN**
15 **WATER’S COMPENSATION PROGRAM?**

16 A9. Yes, and a copy of the Study is included as **Attachment 1** to my testimony.

17 **Q10. PLEASE DESCRIBE HOW THE STUDY WAS CONDUCTED?**

18 A10. Towers Watson utilized three data sources to assess Missouri-American Water’s
19 compensation program: (1) As we did in assessing American Water’s total compensation
20 philosophy, we assessed the design of its short-term at-risk and long-term at-risk
21 compensation programs using proxy disclosures of groups of public utilities referred to as
22 the (1) Large Utility Peer Group, and (2) Small Utility Peer Group, and (3) competitive
23 market positioning of Missouri-American Water’s target total direct compensation levels
24 was compared to Towers Watson published compensation surveys.

1 **Q11. PLEASE DESCRIBE HOW YOU ASSESSED THE COMPETITIVENESS OF**
2 **MISSOURI AMERICAN WATER’S TARGET TOTAL DIRECT**
3 **COMPENSATION LEVELS.**

4 A11. Towers Watson assessed the competitiveness of target total direct compensation provided
5 by Missouri American Water to its short-term at-risk eligible population based on a
6 selection of Missouri-American Water jobs (“benchmark jobs”). Benchmark jobs are
7 those positions that are common across comparable organizations and for which
8 compensation data are available from published surveys.

9
10 To conduct this analysis we reviewed compensation data provided to us by Missouri-
11 American Water and examined Towers Watson’s compensation surveys in our
12 Compensation Databank (CDB). These surveys are comprised of compensation data from
13 over 400 U.S. based companies, and Towers Watson has been conducting these surveys
14 for over 20 years.

15 Missouri-American Water’s current compensation levels were compared to the market
16 50th percentile (market median) for two different market perspectives to determine the
17 competitiveness of pay and to validate the alignment with American Water’s current
18 compensation philosophy (targeting compensation at the 50th percentile of market).

19 To derive 50th percentile (median) market values, Towers Watson weighted energy
20 services and general industry survey data 60% and 40% respectively to place a greater
21 weight on the energy services market data since this includes regulated entities most
22 similar to Missouri-American Water for positions that are not industry specific. Given
23 that these positions can be recruited or lost to companies in any industry, the use of
24 general industry survey data ensures that non-industry specific positions are being
25 compensated competitively. Industry specific positions were compared only to energy

1 services industry data.

2 Towers Watson's assessment of benchmark jobs represents approximately 75% of the
3 population of Missouri-American Water employees as of March 18, 2015, who are
4 eligible for at-risk compensation. Specific details regarding our study, which includes a
5 detailed description of the study methodology, are included in **Attachment 1**.

6 **Q12. PLEASE DESCRIBE HOW YOU DETERMINED THE COMPETITIVENESS OF**
7 **MISSOURI-AMERICAN WATER'S TARGET TOTAL DIRECT**
8 **COMPENSATION.**

9 A12. Two different market perspectives were examined to validate the competitiveness of
10 Missouri-American Water's target total direct compensation.

11 A national market perspective was examined which consisted of the entire population of
12 survey participants in Towers Watson's Energy Services Industry General Industry
13 databases. This perspective represents a U.S. national compensation perspective and is
14 aligned with American Water's compensation philosophy.

15 A Midwest regional perspective including Arkansas, Illinois, Indiana, Iowa, Kansas,
16 Kentucky, Missouri, Nebraska, Ohio, Oklahoma, Tennessee, Wisconsin, and West
17 Virginia labor markets was examined for non-executive positions, which consisted of the
18 same entire survey participant population from Towers Watson's Energy Services
19 Industry and General Industry databases but was customized to identify a Midwest-
20 specific geographic dataset. This dataset identified employees that work in the thirteen
21 states listed above for companies headquartered anywhere in the United States.

22 **Q13. PLEASE DEFINE TARGET TOTAL CASH COMPENSATION.**

1 A13. Target Total Cash Compensation represents the sum of base salary plus target short-term
2 at-risk compensation.

3 **Q14. PLEASE DEFINE TARGET TOTAL DIRECT COMPENSATION.**

4 A14. Target Total Direct Compensation represents the sum of base salary, plus target short-
5 term at-risk compensation, plus long-term at-risk compensation.

6 **Q15. WHAT WERE THE RESULTS FROM THE NATIONAL PERSPECTIVE?**

7 A15. Missouri-American Water’s target total direct compensation as reported in Exhibit 1
8 (below) is below the range of competitive market median by being 18% (represents a
9 weighted average of all positions reviewed) below the market median. Towers Watson
10 and typical market practice define an element of compensation as being competitive if it
11 falls in a range that extends between 10% below to 10% above the market median level
12 of compensation.

13 **Exhibit 1**

Summary of Missouri-American Water Target Total Direct Compensation vs. Market Median (National Market Perspective)		
Base Pay	Target Total Cash Compensation	Target Total Direct Compensation
-19%	-16%	-18%

14

15 **Q16. WHAT WERE THE RESULTS FROM THE MIDWEST REGIONAL**
16 **PERSPECTIVE?**

17 A16. Missouri-American Water’s target total direct compensation is
18 competitive but at the low end of the market median range, as reported in Exhibit 2, because it
19 falls 9% (represents a weighted average of all positions reviewed) below the market median. As
20 discussed above, we consider market competitiveness to fall within a plus or minus 10% of

1 median range.

2

3

Exhibit 2

Summary of Missouri-American Water Target Total Direct Compensation vs. Market Median (Midwest Regional Market Perspective)		
Base Pay	Target Total Cash Compensation	Target Total Direct Compensation
-10%	-9%	-9%

4 **Q17. WHAT WOULD BE THE IMPACT ON THE COMPETITIVENESS OF**
5 **MISSOURI-AMERICAN WATER'S TARGET TOTAL DIRECT**
6 **COMPENSATION IF SHORT-TERM AND LONG-TERM AT RISK**
7 **COMPENSATION WERE NOT PART OF ITS COMPENSATION PROGRAM?**

8 A17. As reported in Exhibits 3 and 4, Missouri-American Water's target total direct
9 compensation would not be competitive because it would fall 28% below median from a
10 national perspective and 19% below median from a Midwest Regional perspective.

11

Exhibit 3

Summary of Missouri-American Water <i>Base Salary</i> vs. Market Median (National Market Perspective)		
Base Pay	Target Total Cash Compensation	Target Total Direct Compensation
-19%	-26%	-28%

12

13

Exhibit 4

Summary of Missouri-American Water <i>Base Salary</i> vs. Market Median (Midwest Regional Market Perspective)		
Base Pay	Target Total Cash Compensation	Target Total Direct Compensation
-10%	-18%	-19%

14

1 **Q18. IN YOUR OPINION AND BASED ON THE RESULTS OF THE STUDY, ARE**
2 **MISSOURI-AMERICAN WATER EMPLOYEES OVERCOMPENSATED?**

3 A18. No. Missouri-American Water employees are below or at the low end of the range of
4 market median for each element of compensation, depending on the market perspective.
5

6 **V. SUMMARY OF TOWERS WATSON'S**
7 **SHORT-TERM AT-RISK PROGRAM ASSESSMENT**
8

9 **Q19. DID YOU CONDUCT AN ASSESSMENT OF AMERICAN WATER'S SHORT-**
10 **TERM AT-RISK PROGRAM?**

11 A19. Yes.

12 **Q20. WHAT WAS THE PURPOSE OF THIS ASSESSMENT?**

13 A20. This assessment was completed to compare the design of American Water's short-term at
14 risk program and its various elements to market practice.

15 **Q21. WHAT WERE THE FINDINGS OF THE ASSESSMENT?**

16 A21. Overall, our review indicates that American Water's annual incentive program is
17 comparable to and competitive with designs of utility peers, based on a review of the
18 Large Utility Peer Group and the Small Utility Peer Group referenced earlier. Like
19 American Water, practically every company in each peer group has a short-term at-risk
20 compensation program which is used to help attract, motivate and retain critically skilled
21 employees needed to successfully run the business. Companies design their short-term at-
22 risk compensation programs to align with their business strategies and circumstances, so
23 there tends to be a range of practices regarding how the programs are designed. American
24 Water's short-term program design is within the range of market practice for utilities.
25 Specific details regarding our assessment are included in **Attachment 1**.

1 **VI. SUMMARY OF TOWERS WATSON'S**
2 **LONG-TERM AT-RISK PROGRAM ASSESSMENT**
3

4 **Q22. DID YOU CONDUCT AN ASSESSMENT OF AMERICAN WATER'S LONG-**
5 **TERM AT-RISK PROGRAM?**

6 A22. Yes.
7

8 **Q23. WHAT WAS THE PURPOSE OF THIS ASSESSMENT?**

9 A23. This assessment was completed to compare the design of American Water's long-term at
10 risk program and its various elements to market practice.
11

12 **Q24. WHAT WERE THE FINDINGS OF THE ASSESSMENT?**

13 A24. Overall, our review indicates that American Water's long-term incentive program is
14 comparable to and competitive with designs of utility peers, based on a review of the
15 Large Utility Peer Group and the Small Utility Peer Group referenced earlier. Like
16 American Water, every company in the Large Utility Peer Group and every company but
17 two in the Small Utility Peer Group has a long-term at-risk compensation program which
18 is used to help attract, motivate and retain key senior level employees needed to
19 successfully run the business. Companies design their long-term at-risk compensation
20 programs to align with their business strategies and circumstances, so there tends to be a
21 range of practices regarding how the programs are designed. American Water's long-term
22 at-risk compensation program design is within the range of market practice for utilities.
23 Specific details regarding our assessment are included in **Attachment 1**.
24

25 **VII. OVERALL FINDINGS**

26 **Q25. WHAT ARE THE CONCLUSIONS OF YOUR ANALYSIS?**

1 A25. Overall, our analysis indicates that Missouri-American Water's total direct compensation
2 programs are comparable to and competitive with market practices of other similarly-
3 sized utilities. Missouri-American Water, like the companies it competes with for talent,
4 has to provide a competitive total direct compensation opportunity delivered via
5 programs that benefit employees, customers and shareholders. Missouri-American Water
6 achieves this goal with its balanced and competitive base salary and short-term and long-
7 term at-risk compensation programs. My experience working with both utilities and
8 general industry companies and the results of the study included as **Attachment 1**
9 indicate the programs at Missouri-American Water fall within a broad range of market
10 norms and are not excessive in design or level of pay.

11 **Q26. DOES THIS CONCLUDE YOUR TESTIMONY?**

12 A26. Yes.