

Exhibit No.:
Issues: Incentive Compensation
Witness: Graham A. Vesely
Sponsoring Party: MoPSC Staff
Type of Exhibit: Surrebuttal Testimony
Case Nos.: ER-2001-672 and EC-2002-265
Date Testimony Prepared: January 22, 2002

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

GRAHAM A. VESELY

FILED³

JAN 22 2002

**Missouri Public
Service Commission**

**UTILICORP UNITED INC.
d/b/a MISSOURI PUBLIC SERVICE**

CASE NOS. ER-2001-672 AND EC-2002-265

*Jefferson City, Missouri
January 2002*

1 **SURREBUTTAL TESTIMONY**

2 **OF**

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4 **UTILICORP UNITED INC.**

5 **d/b/a MISSOURI PUBLIC SERVICE**

6 **CASE NOS. ER-2001-672 and EC-2002-265**

7 Q. Please state your name and business address.

8 A. Graham A. Vesely, 3675 Noland Road, Suite 110, Independence, Missouri
9 64055.

10 Q. Are you the same Graham A. Vesely who has previously filed direct
11 testimony in this case?

12 A. Yes, I am.

13 Q. What is the purpose of your surrebuttal testimony?

14 A. The purpose of my surrebuttal testimony is to respond to the rebuttal
15 testimony of Missouri Public Service (MPS) witness John W. McKinney related to incentive
16 compensation. The Staff remains opposed to charging Missouri customers of MPS for
17 incentive payments relating to achievement of certain financial performance goals.

18 Q. On page 17, lines 11-19 of his rebuttal testimony, Mr. McKinney states:

19 The Commission also needs to realize that the only way these utility
20 employees, managers and executives can increase the earnings of the
21 utility operations is to increase the efficiencies and productivity of the
22 utility. The customers of UtiliCorp receive all of the benefits of these
23 improvements in every rate case and in the states with fuel adjustment
24 clauses they receive the benefits much sooner.

25 Do you have a response to this statement?

1 A. Yes. The Staff recommends that no incentive compensation payments based
2 on financial results of the corporate entity (UtiliCorp) be charged to Missouri customers of
3 MPS. The Staff finds no connection between such financial results and any benefits to MPS
4 ratepayers. For the same reason, the Staff recommends that no incentive payments made for
5 financial results of the business unit called UtiliCorp Energy Delivery (UED) be charged to
6 retail customers of MPS. UtiliCorp describes UED as the business unit responsible
7 domestically for electric and gas delivery activities in seven states. The Staff's approach to
8 the area of incentive compensation is long-standing and reflects previous Commission
9 decisions, as discussed in my direct testimony.

10 Mr. McKinney's statement speaks of utility earnings, efficiency, and
11 productivity without distinguishing between the regulated Missouri operations of MPS, over
12 which this Commission exercises regulatory oversight, and all the other activities of
13 UtiliCorp. The incentive plans call for payments to be made to MPS employees, and charged
14 to MPS customers, specifically based on the financial results not of MPS but of all of
15 UtiliCorp and UED.

16 Q. Are the financial results of MPS's operations of interest to Missouri
17 ratepayers and this Commission?

18 A. Yes, though there are no incentive plan financial goals tied to MPS only
19 results. Further, the Staff would consider MPS earning above its authorized rate of return to
20 be of benefit only to shareholders. The cost of incentives for MPS to earn above its
21 authorized rate of return would properly be assigned only to shareholders. It is, in fact, on
22 the basis of there being Missouri ratepayer benefit that the Staff accepts in concept charging
23 ratepayers for the individual and team goal portion of incentive compensation plans. These

1 types of goals are designed to guide utility employee performance and reward the sort of
2 utility employee achievements that benefit ratepayers by inducing utility efficiency and
3 economy and such achievements. MPS earning above its authorized rate of return is not
4 necessarily the result of utility efficiency and economy. It could be due, for example, to a
5 summer that was hotter than normal, or a reduction in interest rates.

6 Q. Returning to Mr. McKinney's statement, do Missouri MPS customers receive
7 "all of these benefits in every rate case?"

8 A. No. Benefits from improvements in efficiency and economy and such
9 achievements in other UtiliCorp businesses go to the employees and shareholders. Further,
10 the Staff is always mindful of the possibility of increasing corporate earnings at the expense
11 of MPS ratepayers through violation of the Commission's affiliate transaction rules or
12 affiliate abuse in general. Staff Accounting witnesses Cary G. Featherstone and
13 Mark L. Oligschlaeger cover this topic in their testimonies.

14 Q. Beginning on page 18, line 7 of his rebuttal testimony, Mr. McKinney takes
15 issue with your use of language from certain Commission Orders that you cite in support of
16 the Staff's recommended incentive payout disallowance. Please address this portion of
17 Mr. McKinney's rebuttal testimony.

18 A. My direct testimony, to which Mr. McKinney refers, states as follows:

19 The financial goals of achieving a certain level of parent company
20 (UCU) earnings per share (EPS), and the UED financial goal of
21 reaching a certain earnings level, closely meet the Commission's
22 reasons for disallowance cited in Case No. TC-89-14 and TC-93-224.
23 The financial results of UCU's multinational operations, as well as
24 those of UED's interstate operations are too remotely affected by
25 MPS's Missouri operations to justify recovery from Missouri
26 ratepayers. Therefore, the Staff proposes an adjustment to reduce the
27 annualized level of incentive compensation by all the payments made
28 for UCU and UED financial goals.

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1 I was not seeking to imply that there is a Commission Report And Order addressing incentive
2 compensation in a UCU/MPS rate case. In the above I was summarizing the key points
3 drawn from the two cited Commission Orders that in the Staff's judgment are most
4 applicable to this case, since they address the propriety of incentive payments based on
5 corporate and other non-Missouri financial results.

6 Q. Please discuss the next statement that Mr. McKinney makes on page 18 of his
7 rebuttal testimony:

8 The employees charging payroll to the MPS operations are those
9 working for the customers of MPS and the achievements they gain—
10 that enable the earnings of UtiliCorp to be improved—are not related
11 in any way to the international or interstate operations of UtiliCorp.

12 A. I am not entirely clear on what point Mr. McKinney is making here, but he
13 may be seeking to reassure the Commission that UtiliCorp has taken care to charge payroll
14 costs properly, depending on what it is that each particular employee works on. If so, the
15 point is well taken. The Staff has a strong interest in seeing that payroll costs are correctly
16 charged, either directly or by an allocation process, to the activities that require the labor to
17 be expended. The testimony of Staff Accounting witness Charles R. Hyneman reflects the
18 extensive work he performed in this area to formulate the Staff's position on allocation of
19 corporate (UCU) and business unit, such as UED, overhead costs among Missouri retail
20 electric, domestic interstate, and international operations. His testimony also reflects the
21 issues he has with UtiliCorp in this area.

22 The Staff has included in its filed case a proper share of the allocable portion
23 of incentive payments to UtiliCorp employees for non-financial goals. Likewise, since the
24 Staff does not see any benefits resulting to MPS ratepayers from the existing corporate and
25 business unit financial goals, no charges to Missouri retail ratepayers, whether direct or

1 allocated, should be made for these goals. Clearly, earnings objectives are set for the sake of
2 shareholders and employees, as it is to these two groups of stakeholders that the benefits of
3 increased earnings, such as potentially higher dividends, stock prices and salaries, would
4 occur.

5 Q. On page 19 of his rebuttal testimony, Mr. McKinney goes on to point out that
6 under the incentive plans employees' compensation could be higher than under the previous
7 fixed cash method of compensation. What benefits does he state result from this?

8 A. He states that employees become motivated to focus on safety, improving
9 customer satisfaction, improving efficiency and increasing productivity. But here and later
10 on in his rebuttal testimony, when he states that "the most important category is individual or
11 team goals", Mr. McKinney is simply focusing on the aspects of UtiliCorp's incentive plans
12 with which the Staff has already expressed agreement in principle and not made a
13 disallowance.

14 Q. Please explain what you mean by "agreement in principle."

15 A. The Staff agrees in principle that incentive payments made for achieving goals
16 of improved job performance that are of benefit to ratepayers should be recovered in utility
17 rates. An incentive plan designed in such a manner promotes an organizational culture that is
18 improvement-oriented and tied to individual employees' job performances, and one more
19 likely to result in customers receiving value for their utility payments.

20 Q. Does this mean the Staff gives blanket approval to any and all incentive
21 payments as long as the employer describes them as being for non-financial individual/team
22 goals?

1 A. No. Before recommending Missouri ratepayers be charged for this type of
2 incentive compensation the Staff expects to see real improvements in performance and
3 identifiable ratepayer benefits, as the Commission stated in Case No. EC-87-114:

4 At a minimum, an acceptable management performance plan should
5 contain goals that improve existing performance, and the benefits of
6 the plan should be ascertainable and reasonably related to the incentive
7 plan. Staff v. UE, Report And Order at 18.

8 Q. On page 20 of his rebuttal testimony, Mr. McKinney states that employee
9 incentive compensation tied to business unit and corporate financial results is needed to
10 encourage teamwork and financial responsibility. He also states that these goals make up a
11 smaller percentage of employees' incentive compensation than the non-financial goals.
12 Please comment on these statements.

13 A. The UCU Long-Term Executive Incentive Plan is tied 100% to corporate
14 profits, thus no part of it is tied to nonfinancial goals. As far as teamwork goes, the Staff is
15 accepting incentive payouts for achieving the individual/team goals. As I have mentioned
16 above, the Staff wishes to encourage the setting of job performance standards, and the
17 measuring and rewarding of the results achieved by individuals and discrete teams of
18 individuals that are in a position to affect nonfinancial performance that is of benefit to
19 ratepayers.

20 Q. The final argument Mr. McKinney offers in support of his position is the
21 analysis that purportedly shows UtiliCorp's total compensation to be reasonable compared to
22 the market. Please comment on this.

23 A. Mr. McKinney's Schedule JWM-2, page 6, suggests that, for MPS employees
24 listed, fixed compensation plus variable compensation is within about five percent, plus or
25 minus, of market fixed compensation. Not stated, though, is the fact that the incentive, or

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1 "variable" portion of compensation, can go up fifty percent from the "target" level shown in
2 the analysis, if payout is made at the "maximum" level of opportunity prescribed by the plan.
3 Furthermore, the portion of the incentive payout tied to financial goals can contribute to
4 higher incentive compensation without generating any benefits to Missouri ratepayers. The
5 Staff recommends that the Commission not reward incentive plans that produce these results
6 with no substantive benefit to Missouri ratepayers.

7 Q. Does this conclude your surrebuttal testimony?

8 A. Yes, it does.

OF THE STATE OF MISSOURI

In the Matter of the Application of the Tariff)
Filing of Missouri Public Service (MPS))
A Division of UtiliCorp United Inc., to) Case No. ER-2001-672
Implement a General Rate Increase for Retail)
Electric Service Provided to Customers in the)
Missouri Service Area of MPS)

STATE OF MISSOURI)
)
COUNTY OF COLE) SS.

Graham A. Vesely

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NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. JUNE 21, 2004