Recovery of Executive Compensation Expenses in Utility Rate Cases

The recent economic downturn has brought greater scrutiny to executive pay across the country, including within the utility sector. For this reason, it is more important than ever to have a fair and prudent compensation system in place and to carefully monitor pay practices, ensuring that executive pay remains competitive yet reasonable given current economic conditions.

I. Introduction

The recent economic downturn has brought greater scrutiny to executive pay across the country, including within the utility sector. For this reason, it is more important than ever to have a fair and prudent compensation system in place and to carefully monitor pay practices, ensuring that executive pay remains competitive yet reasonable given current economic conditions.

Perceptions that executives may be over-compensated can undermine confidence in the utility’s public service ethic, driving negative outcomes in utility rate cases and lowering customer satisfaction. Such perceptions also can cause resentment among employees who may be facing pay freezes, benefit reductions, and even severances as load growth in many jurisdictions remains anemic.

This article offers practical advice to help utilities structure and present their executive compensation programs in a manner that will
strengthen the case for full rate recovery.

II. Elements of Executive Compensation

Utilities must maintain a competitive total compensation package in order to attract and retain executive talent. Not being able to provide a compensation opportunity equivalent to other firms competing for the same executive talent would challenge any utility’s ability to meet ratepayer’s expectations for reliability and customer service. As the Connecticut Department of Public Utility Control stated succinctly in Southern Connecticut Gas Co., 198 P.U.R.4th 233 (Ct. DPU 2000), “competent management is beneficial to ratepayers.”

Executive compensation in the utility industry is typically comprised of four basic components: base salary, short-term incentive pay (STIP), long-term incentive pay (LTIP), and benefits such as pension and health care. Base salary, STIP and LTIP make up total cash compensation with incentive compensation typically making up a large portion of the total compensation program for executives. Short-term incentives are often formula-driven and have specific performance criteria attached. Long-term incentives can vary for individual executives and may be in the form of cash, stock options, or a combination of the two.

There are key structural differences between compensation practices for executives and compensation practices for other employees:

First, executives are paid more than other employees, and the pay differentials can be significant.

Second, a larger percentage of executive compensation is variable from year to year. For a typical utility employee, variable pay is generally 0 percent to 10 percent of total cash compensation. For utility executives, variable pay can represent as much as 40 percent to 50 percent of total cash compensation. This means that, for executives, total cash compensation can vary significantly (up or down) from year to year based on performance.

Third, executives often receive a portion of their compensation in the form of stock or stock options. Calculating “test period” costs of such programs can be complicated and confusing.

Each of these factors contributes to the unique challenges of designing executive compensation practices that can survive regulatory scrutiny.

III. Regulatory Issues Relating to Executive Compensation

Regulators and utility critics have offered various reasons for disallowances of executive compensation costs. These include:

A. Executives serve shareholders, not customers.

B. Executive compensation costs are just too high.

C. Expert testimony offered in support of executive compensation levels is not persuasive.

D. Variable pay should not be included in rates.

E. Supplemental Executive Retirement Plan (SERP) costs should not be included in rates.

This article addresses these arguments in turn below.

A. Executives serve shareholders, not customers

Officers of a corporation have fiduciary duties of care and loyalty to shareholders. Because officers do not have the same fiduciary duties to customers, some argue that executive compensation costs should be excluded from rates, at least in part. For example, the Washington Utilities and Transportation Commission...
stated: “We recognize that the activities of the executive officers of regulated companies such as PSE confer some benefit on the ratepayers, but the officers’ fiduciary responsibilities run to the shareholders, not the ratepayers. This is a fact that we must keep in mind in considering what part of executive compensation is appropriate for recovery in rates.”

Any notion that utility executives are insensitive to customers’ interests, or “out of touch” with the economic realities consumers face, must be absolutely avoided and dispelled by the utility in rate case proceedings. Quality of service must be maintained and total cost of service must be managed. Evidence of the executive team’s recent, specific achievements and the associated benefits to customers should be presented. Utility executives should maintain direct, one-on-one interaction with customers – through consumer sessions, community outreach, public education, and other venues. Without evidence of a strong public service focus and commitment, executive compensation costs in any amount may be vulnerable.

B. Executive compensation costs are just too high

The Kansas State Corporation Commission recently stated that “requests by utilities for high levels of executive compensation when utility customers suffer under extraordinary economic circumstances present a serious issue.” Incentive compensation programs that are perceived as granting “bonuses” during a period of economic hardship are particularly vulnerable. The Maryland Public Utilities Commission recently remarked that “members of the public are frustrated by the magnitude of CEG’s (and other corporations’) executive compensation.”

With customers struggling to pay their bills, utilities must present compelling evidence to justify rate recovery of high executive compensation costs.

Similarly, the Washington Utilities and Transportation Commission recently stated:

In recent years we have witnessed increasing attention to, and criticism of excessive levels of executive compensation and bloated severance packages. This criticism has come in part from prominent members of the business community who have served on corporate boards.

With customers struggling to pay their bills, utilities must present compelling evidence to justify rate recovery of high executive compensation costs in utility rate cases. In the current economic environment, regulators may be inclined to allow rate recovery of a minimal level of executive compensation expense. The Connecticut Public Utilities Commission stated tersely in a recent case: “the expectation of ratepayers that they receive appropriate service at a reasonable cost in these difficult economic times appears to far overshadow the potential shareholder and executive expectations of increasing personal wealth in today’s world.”

A transparent and objective process for setting executive compensation levels strengthens the case for rate recovery. Executive compensation levels are set by a utility’s board of directors. The extent to which executives may be able to influence the board and/or its executive compensation consultant can be a subject to great interest in rate case litigation. If the utility’s executives have significant power, through the appointment of directors, the appointment of the executive compensation consultant, or the ability to offer other consulting engagements to the consultant, then the level of executive pay may be more difficult to defend. The board of directors should set executive compensation levels based upon market research, experience levels, and individual contribution, and market research should be provided by experts who have no ties to the individual executives and do no other business for the utility.
C. Expert testimony offered in support of executive compensation levels is not persuasive

Most utilities hire a compensation consultant to conduct an annual survey of the compensation packages that other utilities offer. Utilities typically will set a goal of offering compensation at the low, mid, or top tier as compared to other utilities.

One criticism of this practice is that it can appear circular. If most companies target a median or top tier, the utilities at the low end of the scale will respond to each new survey by increasing their own compensation levels. This, in turn, begets further increases in compensation. Moreover, executive compensation levels may be strongly influenced by regulatory decisions, which in turn are influenced by prevailing compensation levels. The California Public Utilities Commission stated that regardless of the potential for circularity, “compensation levels at competitive employers must be considered in order to promote the attraction, motivation and retention of utility employees.”

However, “[s]urveys of other companies, while relevant, are not the only measure in determining whether or not the utility’s requested compensation is just and reasonable.”

Another criticism of compensation studies is that the selection of companies to include in the peer group can be subjective, and compensation consultant conflicts of interest have been alleged. In December 2007, the Congressional Oversight Committee’s Majority Staff issued a report that found, among other things, that “compensation consultant conflicts of interest are pervasive. In 2006 [ ], at least 113 of the fortune 250 companies received executive pay advice from consultants that were providing other services to the company. . . . The fees earned by compensation consultants for providing other services often far exceed those earned for advising on executive compensation.” The Washington Utilities and Transportation Commission stated, “we are wary of studies by consultants that potentially are self-serving and may not provide objective information that is useful to us.” Similarly, the Minnesota Public Utilities Commission rejected comparison studies presented by a regulated utility, stating: “the companies with which NSP chose to compare its salaries, especially officers’ and executives’ salaries, were not truly comparable. . . . [T]he comparison study is less than totally credible and has skewed NSP’s calculations of the market median.”

A further challenge is that some compensation consultants, while highly skilled in other respects, lack appreciation for the regulatory environment in which public utilities must operate. In a recent proceeding, the Nevada Public Utilities Commission disregarded a detailed analysis of executive compensation prepared by a national consulting firm because the firm had refused to provide its proprietary regression analysis to the commission staff in discovery. Some consultants lack experience testifying in regulatory proceedings and fail to devote time and effort required to adequately prepare and present an executive compensation case.

When the board of directors engages an executive compensation consultant, a key part of the engagement should include support through the rate case process. A key part of the engagement of an executive compensation consultant should be support through the rate case process. The compensation consultant must have an objective basis for the selection of peer group companies and be able to explain differences in peer group selections from year to year and among different clients. To address the circularity issue, it may be helpful if the
compensation consultant can provide benchmarking data from both regulated and unregulated industries, where competition is presumed to discipline executive compensation practices. All analysis must be transparent and discoverable.

D. Variable pay shouldn’t be included in rates

Variable or “incentive” pay has many advantages over other forms of compensation, particularly for executives. Yet the rate case process contains many traps for utilities seeking rate recovery of costs associated with variable pay. This is a gauntlet well worth running, but it must be done very carefully.

1. Variable pay has many advantages over other forms of compensation

Variable pay has many advantages over other forms of compensation and these should be clearly explained by the utility in rate case litigation. Variable pay programs make sense on every level and have economic advantages as well as helping with recruitment, retention, motivation, and communication of important business goals.

a. Economics

One of the most significant advantages of variable pay is that the costs associated with a plan can be aligned with performance. With traditional systems, a merit increase based on the previous year’s performance guarantees that the employee retains that rate regardless of future performance. A large merit increase for a great year becomes a permanent financial burden, effectively increasing annual fixed costs. With variable pay, the employee and company as a whole must re-earn the reward every year. If excellent performance is not sustained, variable pay can be reduced or eliminated. Escalation rates can be better managed over time and can quickly be adapted to changing market pressures.

b. Recruitment and retention

Variable pay targets compensation dollars in the right way to the right people and ensures top performers that they will be rewarded for their performance. This type of compensation package offers great opportunity and helps attract high performers who are confident of their abilities. Retention of talent also is improved with variable pay programs in that there is a clear communication of what is expected from the individual executive.

c. Motivation and business goals

The motivational potential of variable pay is stronger than that of other forms of compensation. Variable pay creates a performance culture rather than an entitlement culture. Variable pay that is tied to defined objectives and standards provides a scorecard with a sharp focus on organizational priorities and enables people to continuously evaluate and improve results. By reinforcing positive employee performance, variable pay serves as a catalyst for improving customer service and other important business goals. Executives know exactly what is expected of them and know this performance will be rewarded. By including department level and organization-wide goals within the incentive system, variable pay motivates executives to support each other and to work cooperatively toward common objectives.

d. Communication

Variable pay is one of the strongest signals an organization can send to its executives about what is important. It provides alignment and motivates commitment to the overall business strategy. Key priorities are identified, optimized, clearly understood, and adequately funded. By continually measuring results, high quality feedback is provided.
A wide body of research supports the view that variable pay works. One researcher states, “theory and research show that incentive pay can substantially increase individual and organizational performance, and can represent a powerful tool for establishing a competitive advantage within an industry.” A study by the International Society of Performance Improvement showed that incentive pay programs increase performance by an average of 22 percent. The study showed that team incentives can increase performance by as much as 44 percent. As stated by the Society of Human Resource Management:

Research has demonstrated that some human resource programs and initiatives produce a significant impact on performance in organizations (as measured by factors such as quality, productivity, speed, customer satisfaction and unwanted turnover). The two initiatives that consistently showed statistically significant positive results were linking pay to performance and using variable pay. Research has established the potential of variable pay to produce the desired business results.

Most organizations use variable pay as a significant element of their total rewards package. The 2009-10 WorldatWork Salary Budget Survey reports that 80 percent of responding organizations use short-term incentive pay. A 2009 Hewitt Associates study of 1,156 large organizations reveals that variable pay spending has been steadily growing over the past decade. According to the 2009 survey, in 2009, actual company spending on variable pay as a percentage of payroll increased to 12.0 percent, up from 6.4 percent in 1994. The study reports that companies are budgeting variable pay at 11.8 percent for 2010. Ken Abosch, leader of Hewitt’s North American Broad-Based Compensation Consulting business, added:

> Over the past decade, we’ve seen companies steadily shift from a fixed pay model to one that emphasizes true performance-based awards, and we expect this trend will continue.

Given the benefits and prevalence of variable pay programs, particularly for utility executives, it is critical to understand the regulatory challenges these programs face and to structure the programs in a manner that can address any potential concerns.

2. The argument that variable pay is too uncertain to be included in rates

A significant concern is that the costs of an incentive plan may be included in rates but not earned or paid in the rate effective period, either because the performance goals were not met or because the company retains discretion to withhold payment based upon such factors as the financial condition of the company. Some have argued that the uncertainty surrounding incentive pay justifies removal of the expense from rates. For example, in rejecting rate recovery of costs associated with a utility’s incentive plan, the Minnesota Public Utilities Commission stated:

> Over the past decade, we’ve seen companies steadily shift from a fixed pay model to one that emphasizes true performance-based awards, and we expect this trend will continue.

Another of the plan’s serious defects is that the Company retains the right not to make incentive payments earned under the plan. Management exercised this prerogative in 1992 and did not disclaim its ability to do so in the future. This is a clear case of transferring risk from shareholders to ratepayers. If expenses are unexpectedly high or revenues unexpectedly low, shareholders can offset these losses with funds provided by ratepayers for the incentive compensation program. This runs contrary to the test year concept on which rates are based, and the Commission strongly disapproves.

Executive compensation varies more, year over year, than that of non-executives. As noted above, variable pay typically comprises a much higher percentage of...
total cash compensation for executives than for non-executives. Moreover, while variable pay for non-executives generally is tied to short-term (one-year) goals, variable pay for executives may focus on longer-term objectives. The Connecticut Department of Public Utility Control recently noted, “[b]ecause long-term incentive payments incorporate longer periods of performance measurement, their variability is likely to be greater than short-term payments; therefore, they present an even greater problem in ratemaking than do short-term payments.”

Utilities should be prepared to explain in rate case litigation significant year over year changes (positive or negative) in variable pay levels. If the differences are dramatic, normalization of executive compensation expense through averaging may be appropriate. The normalized values must be justified as reasonable for inclusion in rates.

3. The argument that variable pay plans primarily benefit shareholders, not customers

Several arguments are commonly made in support of allocating a portion of costs of variable pay plans to shareholders.

First, if the executives do not earn their variable pay, but 100 percent of the expected cost is included in rates, then the shareholder receives a windfall. The shareholder is receiving rate recovery of a non-existent expense. Thus, for example, in support of its decision denying rate recovery of incentive compensation expenses, the Florida Public Service Commission noted that “if the company does not meet its financial performance targets, the incentive compensation payments can be reduced while the shareholders retain the revenues paid by ratepayers for those incentive compensation programs.”

Second, if the executives do earn their variable pay, “[t]he benefits of improved employee performance...accrue to investors in the form of higher share prices and dividends.”

Thus, there is an argument that the costs of the incentive pay program should be paid by shareholders, not customers. Metrics tied to earnings per share, if included in an incentive pay plan, create particular vulnerability. The Minnesota Public Utilities Commission recently stated:

The Commission continues to consider earnings per share thresholds an improper transfer of risk, since ratepayers bear the risks (the costs of incentive compensation) and shareholders reap the benefits (increased earnings per share). The Commission also continues to believe earnings per share thresholds can jeopardize a utility’s commitment to providing safe, reliable, economical service over the long-term by over-emphasizing short-term performance. In most private business contexts, short-term thinking is merely unfortunate. In the public utility context, it can create a public crisis.

The Massachusetts Department of Public Utilities has allowed financial performance as a “threshold component” of variable pay, so long as the metrics used to determine the amount of payout focus on customer interests:

Going forward, where companies seek to include financial goals as a component of incentive compensation program design, the Department would prefer to see the attainment of such goals as a threshold component with job performance standards designed to encourage good employee performance (e.g., safety, reliability, and/or customer satisfaction goals) used as the basis for determining individual incentive compensation. Companies that wish to maintain the achievement of financial metrics as a direct component of an incentive compensation award must be prepared to demonstrate direct ratepayer benefit from the
Some jurisdictions require specific quantification of the benefits of incentive compensation to customers – an extremely difficult burden. Regulators also have required that the performance metrics be objective and measurable. The Kansas Corporation Commission recently excluded incentive compensation from rates, concluding that, “the relationship between KCPL and GPE’s short-term executive compensation plans and benefits to KCPL ratepayers is simply too tenuous to include in cost of service.” If an incentive program provides benefits for both ratepayers and shareholders, the costs may be partially recoverable in rates. Thus, for example, the California PSC has allowed recovery in rates of 50 percent of short-term incentives. However, determining an appropriate allocation can be challenging. The Connecticut Department of Public Utility Control recently stated:

As utilities become more competitive, the variability of annual incentive payment amounts is likely to increase. Because of this variability and the difficulty of distinguishing goals that benefit ratepayers from those that benefit shareholders, it may be difficult to determine the portion of incentive payments that represents reasonable costs in a rate case. It is usually even more difficult to determine whether the goals can and will be achieved cost effectively and whether the value of achieving these goals is worth the additional executive compensation expense.

When incentives represent a significant percentage of total compensation (as they typically do for executives), the plan’s performance metrics may receive particular scrutiny. The Minnesota Public Utilities Commission stated:

The fact that incentive compensation is such a high percentage of overall compensation is a warning flag for the Commission - executives and officers will be extremely focused on the achievement of the program goals. The Commission must therefore scrutinize the choice of incentives very critically.

In order to strengthen the case for rate recovery, performance objectives underlying variable pay plans should be carefully crafted with a strong customer focus in mind. The Federal Energy Regulatory Commission has encouraged, but not required, that management programs, including executive incentive compensation, give appropriate weight to responsiveness to customers and other stakeholders. The West Virginia PSC ordered a utility to revise its incentive compensation plan to add “a strong but balanced emphasis … on customer service and responsiveness, in relation to the other performance indicators.” The Minnesota Public Utilities Commission stated that acceptable criteria in an incentive compensation plan would include “quantifiable goals relating to safety, customer satisfaction, productivity, cost control, and individual employee performance.” The Illinois Commerce Commission has identified as acceptable goals “OSHA Recordable Injuries, Energy Efficiency, Gas Leak Response Objectives, and Gas Compliance.” If financial performance objectives are used, every effort should be made to clearly show how achieving these measures benefits the customers.

4. The argument that variable pay in the form of stock or stock options should not be included in rates

There are at least three challenges in defending rate recovery of variable pay in the form of stock or stock options. First, the degree of uncertainty is much greater than it is with variable pay plans that pay out as a simple percentage of base pay. The actual value that executives will receive will depend on whether the requirements of the
long term incentive plan have been met and the value of the utility’s stock at the time the shares vest. In denying rate recovery of stock-based compensation, the Federal Energy Regulatory Commission stated:

The Commission finds that the ALJ’s decision to exclude from WNG’s cost-of-service the accrued amount of EICP stock awards was reasonable. This cost component is too speculative to be used as a representative amount. This amount represents stock awards that were not vested in either the base period or test period and, in fact, may never vest. Even if vesting occurs, it might not occur until after the rates in this proceeding become effective. In addition, some executives leave the company before their stock awards have vested and the price of stocks is volatile in nature. Moreover, WNG fails to point to any record evidence to show that the costs related to the stock award component of the EICP are not speculative. A mere claim that the stock award component of its EICP “tends” to attract (and hold) qualified personnel to the benefit of its ratepayers without more is insufficient. Under these circumstances, we agree with the ALJ that the costs are not known or measurable and are too speculative.42

For rate recovery purposes, relying on awards actually made in the test period (rather than accruals), and normalizing these amounts to account for significant year-over-year variances, may be more successful than requesting accrued amounts that have not vested.

Second, variable pay in the form of stock or stock options does not require a cash outlay by the company either when the up-front promises are made or when the shares actually vest. While the stock is diluted by the issuance of treasury shares, no cash payment occurs. This element of executive pay cost is therefore different from nearly every other element of revenue requirement in a rate case, which can be tied to a specific cash expense in the accounting records of the company. The Federal Energy Regulatory Commission has criticized stock option plans, stating that “there is no practical method of accounting for stock options which will give a clear indication of their cost to the company.”43 At an intuitive level, the dilution of company stock may strike some utility critics as a shareholder concern not appropriate for recognition in utility rates. The link between the variable pay program, the Company’s financial position, and the customer must be clearly explained in the application requesting rate recovery.44

Third, variable pay in the form of stock or stock options may be perceived as aligning executives’ personal financial interests with those of shareholders (as opposed to the customers). The Federal Power Commission stated nearly half a century ago:

The function of regulatory agencies is to exercise a positive influence on the welfare and growth of this industry which is fundamental to the progress of our entire economy by controlling rates and profits and by focusing the attention of management on their public service responsibilities. The incentives under stock option plans, however, tend naturally to divert management from their responsibilities to the public and to focus their attention on maximizing prices and earnings in order to push stock quotations ever higher. ***

The goal here must rather be effectiveness in the performance of a public service and the measure of executive endeavor is and must remain not the judgment of the stock market on present and future profits but success in providing a service upon which our entire economy is dependent, not at the highest prices which can be obtained but at the lowest rates consistent with the health of the industry and its ability to care for the future needs of its customers. An overriding personal stake in the stock market is doubtfully compatible with the public service responsibilities of the management of a public utility. The electric power industry of today recognizes that it must perform its work with a broad regard for the interests of consumers and the general public, as well as the interest of
stockholders and management. Stock option plans do not lend themselves to this balanced management attitude.45

In support of a recent decision to deny recovery of the costs of stock-based compensation, the Arizona Corporation Commission recently stated: “ratepayers should not be required to fund the costs of a program that is based on the company’s, or its parent company’s, stock price.”46 Similarly, the Michigan PSC recently stated: “The Commission finds that Detroit Edison’s request for projected 2009 stock option expenses, performance shares expenses, restricted stock expenses, and executive deferred compensation gains expenses should be rejected. These expenses are used to encourage executives to promote the financial performance of Detroit Edison, which mainly benefits the company’s shareholders, not its ratepayers.”47 Aligning the performance goals with customer objectives, such as cost control and quality of service, can strengthen the case for rate recovery.

F. The argument that Supplemental Executive Retirement Plan costs should not be included in rates

Many utilities offer their executives SERP plans, although this practice is becoming less prevalent. SERP plans for highly compensated individuals are provided because benefits under the general pension plans are subject to certain limitations under the Internal Revenue Code. In general, the Internal Revenue Code allows for the computation of benefits on an annual salary up to $240,000. SERP plans provide benefits in addition to the benefits provided under the general pension plan of the company. In addition, some executives are covered by a richer benefit formula or have a greater portion of total compensation counted than under the basic pension plan, and therefore receive benefits that non-executives would not receive even if they earned the same compensation as the executives.

Regulators in some jurisdictions question whether SERP expense is necessary to recruit and retain qualified executives. For example, the Connecticut Department of Public Utility Control stated, “A specific current concern in industry regulation has been the disregard by upper management for the impact of generous executive compensation packages on the rate paying public.

Funding a supplemental retirement plan for the exclusive benefit of executives at a rate substantially higher than that afforded to non-executive employees at the expense of ratepayers is of concern to the Department and subject to review in the Company’s next rate proceeding.”48 Similarly, the Arizona Corporation Commission recently stated, “ratepayers should not be required to fund the retirement benefits of a few select executives whose salaries exceed current IRS limits.”49 Utilities seeking to recover these types of expenses should support the request with market research supporting the reasonableness of the program at the time the benefits vested.

IV. Recommendations

In building a case to support rate recovery of executive compensation expense, this article offers the following recommendations for utilities:

- Executive compensation should be set by the board of directors with the assistance of a compensation expert who is highly qualified, whose analysis is highly transparent, and who has sufficient regulatory expertise to support the rate recovery process throughout case preparation, discovery and public hearings.
- Significant variances in year-over-year executive pay should be explained.
Variable pay plans should be strongly tied to customer objectives, such as reliability, safety, and customer satisfaction.

Specific, recent accomplishments of the executive team, and the associated benefits to customers, should be highlighted.

Endnotes:

2. Atmos Energy, 2010 WL 3200341 at *91 (Ks. S.C.C. July 30, 2010). See also, e.g., Golden State Water Co., 2010 WL 4912438 (Cal. PUC Nov. 19, 2010) (“The level of rate increases sought and executive compensation were particularly troublesome to the speakers given the current economic crisis and its personal impact on many of Golden State’s customers. One sentiment expressed over and over again was that citizens of the state and nation are being forced to tighten their belts and Golden State should do so as well. The Commission is mindful of ratepayers’ concerns voiced at the public participation hearings and our review of Golden State’s applications is undertaken within the broader context of the current economic situation.”); Gas, Inc., 280 PUR4th 505 (Az. Corp. Comm’n. 2010) (“current economic conditions should cause utility companies to reconsider whether it is appropriate to seek recovery from captive ratepayers of incentive programs, such as providing stock options to management and employees.’’).
3. Progress Energy Florida, 2010 WL 867088 (Fl. PSC Mar. 5, 2010) (“Especially in light of today’s economic climate, we believe that PEF should pay the entire cost of incentive compensation, as its customers do not receive a significant benefit from it.’’).
6. Southern California Edison Co., 2009 WL 801553 (Ca. PUC Mar. 12, 2009) (“in light of the current economic situation and the dire financial circumstances many Californians find themselves in, it is reasonable to limit the level of executive compensation ratepayers are responsible for provided such reductions do not result in total compensation levels falling below the amount required for Edison to attract and retain employee”).
9. Id.
12. Northern States Power, 146 PUR4th 1 (Mn. PUC 1993). But see Williams Natural Gas Co., 80 FERC ¶ 61,158 (1997) (“the objections to including the accrued cash awards are meritless because the accrued cash awards are in fact known and measurable and not speculative’’); West Virginia American Water Co., 231 PUR4th 423 (W.V. PSC 2004) (“Indeed, incentive compensation is a known and measurable expense in this case. It was contained in the test year and shall be allowed for ratemaking purposes.’’).
16. Id.
20. Id.
21. Id.
22. Id.
23. Northern States Power, 146 PUR4th 1 (Mn. PUC 1993). But see Williams Natural Gas Co., 80 FERC ¶ 61,158 (1997) (“the objections to including the accrued cash awards are meritless because the accrued cash awards are in fact known and measurable and not speculative’’); West Virginia American Water Co., 231 PUR4th 423 (W.V. PSC 2004) (“Indeed, incentive compensation is a known and measurable expense in this case. It was contained in the test year and shall be allowed for ratemaking purposes.’’).
to demonstrate the variability associated with these costs and explain why they should be averaged instead of adjusted out of the Company’s proposed test-year expenses.”


28. See also, e.g., Michigan Cons. Gas Co., 282 PUR4th 1 (Mi. PSC 2010) (“the Commission observes that Mich Con’s proposed EICP remains 50% focused on cash flow and shareholder value and that many of Mich Con’s EICP goals that benefit ratepayers are already requirements imposed by the Commission’s Service Quality and Reliability Standards. Thus, Mich Con’s incentive compensation plan does not provide additional benefits to ratepayers commensurate with the costs of the program.”); Narragansett Elec. Co., 281 PUR4th 161 (RIFSB 2010) (“In this case, the Commission is not persuaded that the $2.4 million cost associated with incentive compensation is wholly for the benefit of ratepayers. The Commission believes Mr. Effron’s testimony that benefits tied directly to the Company’s financial performance are not benefits directly benefiting ratepayers and finds the Division’s position to be meritless. Additionally, the Commission cannot justify increasing rates in order that NGrid attain higher profits and higher stock prices or shareholder value. The Commission finds Mr. Dowd’s testimony unpersuasive in establishing any link between the Company’s attainment of financial goals and ratepayer benefits.”); Progress Energy Florida, 2010 WL 867088 (Fl. PSC Mar. 5, 2010) (“incentive compensation tied to [earnings per share] should not be passed on to ratepayers”); Empire District Elec. Co., 2008 WL 1795006 (Mo. PSC Mar. 26, 2008) (“We conclude that incentive compensation for meeting earnings goals, charitable activities, activities unrelated to the provision of retail electric service, discretionary awards, and stock options should not be recoverable in rates.”). In jurisdictions with performance based rates, where customers may benefit from “over-earnings,” regulators have shown more flexibility regarding incentive pay. E.g., New England Gas Co., 2004 WL 22677185 (RI PUC Aug. 23, 2004) (“Because under the ESM ratepayers receive 50 percent to 75 percent of over earnings, and 50 percent of merger savings are shared with ratepayers, it appears fair and reasonable for 50 percent of the incentive compensation related to achieving earnings, or $173,500 to be included in the ESM calculation. However, in the future, the Commission will remain vigilant to insure that an incentive does not become too large, too easy to achieve, or become based on factors that are a detriment to ratepayers.”).

29. Northern States Power, 146 PUR4th 1 (Mn. PUC 1993). Similarly, in Minnegasco, 170 PUR4th 193 (Mn. PUC 1996), the Commission stated:

The level and structure of these particular plans are likely to lead officers to focus their energy on corporate balance sheets rather than the judgments and decisions which can directly affect ratepayer service and satisfaction. In situations in which short-term financial goals may conflict with the long-term policies necessary to achieve safe, reliable, and reasonable service, officers will be financially rewarded by seeking the short-term financial goal.

The Commission’s disallowance of the costs of these programs is not meant to discourage incentive compensation plans that are appropriately designed to stimulate employee creativity, productivity, and loyalty. Disapproval of the particular structure and terms of these plans does not mean that the Commission should, or wishes to, design utility compensation programs in the future. This disallowance simply means that in this particular case, where the plan forms a very high percentage of total compensation, and the program incentives are questionable, the Commission will disallow all costs except the small percent tied to direct ratepayer benefit. See also, e.g., Central Illinois Public Service Co., 2003 WL 23473070 (Ill. Comm. Oct. 22, 2003) (“While there also may be cases in which the Commission permitted a utility to recover incentive compensation costs for a program that primarily conferred a clear benefit on the ratepayers, the Commission finds that the instant proceeding is not such a case”); New England Gas Co., 271 PUR4th 1 (Ma. DPU 2009) (“the Department finds that the Company has failed to demonstrate that the Annual Incentive Plan for SU’s corporate employees and the Amended Bonus Plan for SU’s president and senior executive vice president are reasonably designed to encourage good employee performance and will result in benefits to NEGC’s ratepayers”).


34. E.g., Gas, Inc., 280 PUR4th 505 (Az. Corp. Comm’n. 2010) (“a 50/50 sharing of incentive compensation costs provides a reasonable balancing of the interests between ratepayers"
and shareholders. The equal sharing of such costs recognizes that the program is comprised of elements that relate to the parent company’s financial performance and cost containment goals, matters that primarily benefit shareholders, while at the same time recognizing that approximately 40 percent of the program’s incentive compensation is based on meeting customer service goals. This offers the opportunity for the Company’s customers to benefit from improved performance in that area.”); Southwest Gas Corp., 270 PUR4th 465 (Az. Corp. Comm’n. Dec. 24, 2008) (same); Washington Gas Light, 98 Md. PSC 508 (Md. PSC 2007) (allowing recovery of 50% of incentive compensation”).


37. Minnegasco, 170 PUR4th 193 (Mn. PUC 1996). Compare Southern California Edison Co., 235 PUR4th 1 (Ca. PUC 2004) (“If SCE had decided that the total cash compensation received by executives should be in the form of base salary without any incentive plan, there presumably would be no issue of ratepayer cost responsibility as long as total compensation for executives is at market levels. In the absence of any evidence that the executive incentive program itself produces outcomes that are contrary to ratepayer interests, we will not interfere with the utility’s discretion to adjust the appropriate mix of base salary and incentives.”).

38. Order No. 719, FERC Stats. & Regs. ¶ 31,281 at ¶ 561; see also Wholesale Competition in Regions with Organized Electric Markets, 128 FERC ¶ 61,059 at ¶ 182 (2009).


41. Central Illinois Light Co., 2010 WL 1868345 (Ill. Comm. Comm’n. Apr. 29, 2010). See also, e.g., Investigation Into Any And All Matters Related To Commission Approval Of Participation

By Indiana End Use Customers In Demand Response Programs Offered By The Midwest ISO And PJM Interconnection, 2009 WL 605637 (Ind. URC Feb 25, 2009) (“The Commission continues to encourage, but not require, each RTO and ISO to ensure that its management programs, including executive compensation, give appropriate weight to responsiveness to customers and other stakeholders. If the RTO or ISO board is well-informed about the needs of customers and various stakeholders, it will set criteria for performance, appropriate goals and targets for the organization and its management and institute measures for achieving those targets. By focusing our requirements on having a well-informed board, we decline to intrude further into board prerogatives regarding management compensation.”).


44. See, e.g., Entergy Arkansas, Inc., 258 PUR4th 1 (Ark. PUC 2007) (“‘EAI offers no substantial evidence of ratepayer benefit which would justify including these stock-driven incentives in rates’”). See also, e.g., Order at 134–35, Southern California Edison, 2009 WL 801553 (Cal. PUC Mar. 12, 2009) (“We reject SCE’s request to include $23.304 million in long-term incentives in its TY forecast. As DRA and TURN note, these incentives have not been included in rates in the past and are closely tied to stock performance of the parent company, Edison International and, therefore, to non-utility activities”).


48. Connecticut Water Co., 2009 WL 246929 (Ct CPUC Jan. 28, 2009); see also, e.g., Southwest Gas Co., 270 PUR4th 468 (Az. Corp. Comm’n 2008) (“Without the SERP, the Company’s officers still enjoy the same retirement benefits available to any other Southwest Gas employee and the attempt to make these executives ‘whole’ in the sense of allowing a greater percentage of retirement benefits does not meet the test of reasonableness. If the Company wishes to provide additional retirement benefits above the level permitted by IRS regulations applicable to all other employees it may do so at the expense of its shareholders. However, it is not reasonable to place this additional burden on ratepayers.”).

49. Gas, Inc., 280 PUR4th 505 (Az. Corp. Comm’n. 2010). See also, e.g., Providence Gas v. Malachowski, 656 A.2d 949, 952 (R.I. 1995) (upholding PUC decision finding SERP expense excessive and unnecessary). But see, e.g., Washington Utilities & Transp. Comm’n., 281 PUR4th 329 (Wash. UTC 2010) (“The ultimate issue is whether total compensation is reasonable and provides benefits to ratepayers, not whether incentive compensation is pay in stock or whether compensation, particularly for executives, is similar to that of other comparable companies. The Company’s SERP meets this test. Taken as part of the overall compensation package, it is reasonable as a common feature of a market competitive pay program in the utility industry.”).