

BEFORE THE CORPORATION COMMISSION OF OKLAHOMA

IN THE MATTER OF THE APPLICATION OF)
OKLAHOMA GAS AND ELECTRIC COMPANY)
FOR AN ORDER OF THE COMMISSION)
AUTHORIZING APPLICANT TO MODIFY ITS)
RATES, CHARGES, AND TARIFFS FOR)
RETAIL ELECTRIC SERVICE IN OKLAHOMA)

CAUSE NO. PUD 201800140

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CORPORATION COMMISSION
OF OKLAHOMA

Direct Testimony

of

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Senior Partner at Mercer, Inc.

on behalf of

Oklahoma Gas and Electric Company

December 31, 2018

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Mike Halloran
Direct Testimony

1 **Q. Please state the name, occupation and business address of the Witness.**

2 A. My name is Michael Halloran. I am a Senior Partner at Mercer (US) Inc. (“Mercer”), which
3 provides best-in-class expertise in the areas of executive and employee compensation and
4 benefits, pay-performance alignment, and corporate governance. My business address is
5 4400 Comerica Bank Tower, 1717 Main Street, Dallas, TX 75201.

6
7 **Q. Please provide an overview of the witness’s educational and professional experience.**

8 A. I have a Bachelor of Arts in mathematics from Northwestern University and a Master’s in
9 Business Administration from Northwestern’s Kellogg School of Management
10 specializing in accounting and finance. I am a Senior Partner at Mercer, specializing in
11 compensation consulting, and am considered the leading practitioner at the Company. I
12 have over 30 years’ experience in the field. Prior to joining Mercer in 2001, after Mercer
13 acquired the firm I was with, SCA Consulting, I was a VP and head of executive
14 compensation consulting at Willis Towers Watson (previously Towers Watson). In 2014,
15 I was named one of the top 25 consultants in the US by *Consulting Magazine*. I have
16 worked with a number of utilities on compensation matters, including DTE, Great Plains,
17 Evergy and Washington Gas & Light, in addition to OG&E.

18
19 **Q. Have you testified previously as an expert witness?**

20 A. I have testified in rate cases in the States of Missouri (Kansas City Power and Light) and
21 Oklahoma (OG&E), and in the District of Columbia (Washington Gas & Light) and have
22 also testified as an expert witness in federal and state courts on reasonable compensation
23 cases.

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

25 A. The purpose of my testimony is to provide the Commission perspectives on the
26 reasonableness of the base pay and the annual variable pay components of the overall
27 compensation program at OG&E. These components are essential to attracting and
28 retaining staff and employees that provide continual and reliable services to OG&E
29 customers. Overall, these components are a necessary and reasonable cost of doing

1 business, and thus it is appropriate to include these costs in the overall rate base.

2 **Overview of Compensation Practices**

3 **Q. Can you generally summarize OG&E's compensation objectives and philosophy?**

4 A. The Company is responsible for meeting the obligation to provide reliable, and safe,
5 electric service to its customers at a reasonable cost. This is not an easy task because of
6 ongoing changes in regulatory compliance requirements, customer expectations and
7 introduction of new technology. This requires OG&E to retain a talented, highly
8 motivated, and experienced work force. OG&E provides competitive, but reasonable,
9 compensation and benefits to its existing and prospective staff and employees as the
10 Company faces competition from other utilities and industries, especially the energy
11 industry in and around Oklahoma City. The need to recruit additional talent is evidenced
12 by OG&E's aging workforce, where approximately 17% of the experienced staff have
13 retired in the past four years.

14 OG&E's compensation programs are designed to support the Company's overall
15 objectives. The programs have key components that are substantially performance-based
16 and that align with the interests of the organization's business strategy and ultimately the
17 Company's stakeholders. OG&E incorporates the establishment of market-based levels
18 of compensation that enable the Company to compete for, attract and retain experienced,
19 motivated and diverse employees with skill sets necessary to execute the business
20 strategy. The compensation levels are targeted at the median (i.e., 50th percentile) of the
21 market.

22 Linking pay to performance is key to OG&E being a performance driven
23 company. OG&E's total compensation programs allow employees to personally succeed
24 when they and the Company perform well. OG&E uses peer groups to establish market
25 levels of compensation that reflect the industries and companies competing with OG&E
26 for highly qualified employees. The Company offers compensation levels that are
27 competitive with median levels in the marketplace. OG&E offers its employees the
28 opportunity to earn competitive incentive awards that aid in driving performance
29 initiatives that are aligned with business goals. Competitive incentive compensation is
30 based on the achievement of expected performance targets, with upside potential tied to
31 achieving superior performance.

Compensation Studies

Q. **How does OG&E determine its cash compensation levels are reasonable and market competitive?**

A. The Company does an extensive analysis annually to measure and determine the level of competitiveness of its overall cash compensation programs. The Company uses data provided by independently verified third-party salary surveys and compares the Company's salaries to the external market data. Once an OG&E job is matched to a benchmark in a third-party survey data, it is either placed within a salary grade structure or assigned a market value, and the pay for an employee who is tied that grade or market value will then be determined based upon the employee's performance, experience, education level, skills, and training.

The Company also sets annual incentive compensation targets, which is the annual compensation available to employees if targeted levels of performance are met under the Short-term Incentive (STI) program. The annual incentive targets are set as a percentage of annual salary, and they are designed so that when annual salary and STI are combined for a position, they deliver market competitive cash compensation. Total cash compensation data is reviewed on an annual basis to ensure that annual incentive targets remain appropriate for delivering market-competitive cash compensation.

In preparation for this testimony, Mercer has done a detailed audit of the processes used and the results determined by OG&E's staff regarding the competitiveness of its overall program. This testimony is based on the results of this review.

Q. **What was the purpose of the Company's compensation studies?**

A. OG&E performs an extensive annual market analysis to assess the competitive positioning of its jobs in comparison to external market benchmarks in order to ensure that the Company remains competitive and fiscally responsible in its compensation programs. This is consistent with practices at other organizations.

1 Q. **How was the analysis performed?**

2 A. OG&E's compensation programs, including base salary and incentive compensation,
3 were compared against data from relevant independently verified compensation surveys
4 for the utility and general industries.
5

6 Q. **What positions were analyzed in the most recent compensation study?**

7 A. Overall, OG&E selected about 225 jobs from a variety of utility and corporate jobs
8 representative of positions at the Company at various levels where valid and reliable
9 external survey benchmarks were available. The jobs analyzed covered approximately
10 67% of the current employees. This sampling approach is consistent with best practices
11 at other leading companies.
12

13 Q. **What survey sources were used?**

14 A. The following external survey sources were used to support the compensation analysis:
15 Aon Independent Energy HR Association, Mercer MTCS, Mercer Cross Segment,
16 Mercer Benchmark Database, and Willis Towers Watson CDB Compensation Survey
17 Report.
18

19 Q. **What elements of compensation were included in the analysis and why were these
20 elements included?**

21 A. The analysis of competitive data included the two key elements of pay for all employees:
22 1) base salary, and 2) target total cash compensation (which is the sum of base salary
23 plus target short-term incentive). The Company performs this analysis on an annual basis
24 to ensure that its compensation practices are aligned with current market trends. It is
25 important to not only look at compensation as a whole, but also review how each
26 component of the Company's total compensation relates to the market data and relevant
27 trends. This analysis requires extensive experience and knowledge of compensation
28 trends and actual jobs to accurately benchmark OG&E against other companies. By
29 looking at each component, the Company is better positioned in both the regional and
30 industry-specific markets to attract available talent.

1 Q. **How does OG&E's base salaries and total cash compensation compare to market**
2 **levels?**

3 A. A detailed comparison of OG&E's compensation relative to the survey data at market
4 competitive levels (50th percentile) shows that OG&E's target cash compensation levels
5 (base salary plus target annual bonus) are competitive relative to similar companies.
6 Specifically, overall base salaries were at 97.3% of the market median (i.e., within 3%),
7 while target cash compensation levels were at 98.8% of the market median (i.e., within
8 2%).

9 However, without the additional pay provided by the annual short-term incentive
10 plan, OG&E base salaries alone would be approximately 10% below the market median
11 for target cash compensation overall, which could be a significant competitive
12 disadvantage.

13 **Perspectives on Annual Cash Incentive Programs**

14 Q. **Please describe the various types of employees that work for OG&E and how each**
15 **type of employee is compensated.**

16 A. OG&E has the following general employee categories:

17 **Officers/Executives (Vice Presidents and Above & Directors).** Their
18 compensation consists of base salary, short-term cash incentive compensation
19 ("STI"), and long-term incentive compensation ("LTI").

20 **Managers/Supervisors/Professionals.** The compensation of these employees is
21 comprised of base salary and STI.

22 **Nonexempt Clerical/Technical/Craft.** The compensation of these employees is
23 comprised of base salary, overtime earnings and STI.

24
25 Q. **Please describe OG&E's cash compensation programs.**

26 A. OG&E's cash compensation programs are composed of mainly base salary and incentive-
27 based cash awards. To a smaller extent, the Company also offers Performance
28 Recognition Cash Awards. The Performance Recognition Awards are generally offered
29 to employees in jobs below the executive level. The Performance Recognition Cash
30 Award program is intended to reward individual contributions to key initiatives of the
31 Company. Management, in its sole discretion, determines whether employees will

1 receive a Performance Recognition Cash Award for their contributions outside of the
2 employee's day-to-day duties (e.g., complex annual audit, special projects or other key
3 events of a similar nature as defined by senior management). The awards are not
4 predefined and are proposed at the discretion of management from time to time as
5 appropriate.

6 The STI plan has a one-year performance cycle. All full-time employees are
7 eligible to participate. Each eligible employee has a target percentage assigned based on
8 their salary grade level. STI payouts are based on the level of achievement met for each
9 performance metric. OG&E's STI plan is provided to motivate and reward its employees
10 to drive performance, particularly in the areas of safety, customer service and fiscal
11 responsibility. The STI performance measures are designed using a balanced scorecard
12 approach, which includes a combination of operating performance measures and
13 traditional financial performance measures, to provide employees a holistic framework
14 to help drive successful organizational performance. OG&E combines Customer
15 Satisfaction, Safety, Operating and Maintenance Expense and Earnings per Share as
16 operating performance metrics. Successful performance against key operating metrics is
17 important for the customer, as they lower costs and improve efficiency and reliability.
18 Financial metrics also benefit customers because they are indicative of how well the
19 utility is run over time. A healthy utility with reasonable investor returns compared to its
20 peers ultimately lowers costs to customers through better credit metrics and a lower cost
21 of capital. This allows for further investments in infrastructure that also benefits
22 customers.

23
24 **Q. Why is there a need for a Short Term Incentive Plan?**

25 **A.** There are several key reasons why organizations use STI plans: (a) attracting talent
26 demands this form of cash compensation; (b) over the years, surveys of employees across
27 the US (and at (OG&E)) have indicated that variable compensation is a high priority for
28 employees in terms of identifying the value proposition an organization can provide; (c)
29 variable compensation is more cost effective because variable pay is only earned and
30 awarded based on meeting business performance goals.

31 If OG&E was to eliminate STI, the organization would need to increase base

1 salaries in order to maintain market competitive cash compensation levels. As noted
2 earlier, the detailed compensation study performed by OG&E indicates that base salaries
3 are 10% below the median cash compensation (base salary plus STI) offered in the
4 market.

5
6 **Q. Does OG&E's STI plan have any metric threshold limits before a pay out on any**
7 **metrics?**

8 A. No. Similar to other plans within the industry, OG&E's STI plan does not require a
9 threshold on any one metric before paying out on other metrics. For example, if the metric
10 for O&M is not met, STI can still pay out on the remaining three metrics (Safety,
11 Customer Satisfaction and Earnings per Share), and vice versa. No one metric is the
12 driving force for paying out on another metric; however, the metrics are weighted
13 differently.

14
15 **Q. How does the design of OG&E's incentive compensation plans benefit the**
16 **customer?**

17 A. The design of the program with four separate components all ties to key customer
18 outcomes and is best practice in the utility industry. The achievement of EPS goals
19 provides the cash for future investment in the utility, which benefits customers. The
20 focus on O&M spending impacts reliability of service to customers. The Customer
21 Satisfaction metric drives employees to deliver the most reliable service possible.
22 Finally, the focus on Safety is good for the community and reduces cost over time.

23 The use of multiple metrics provides balance. For example, if the Company
24 chooses to forgo performing regular maintenance to its assets to reduce expenses, it will
25 suffer from potential lower customer satisfaction and safety scores. Conversely, if the
26 Company spends excessively, its financials will reflect a higher cost structure which may
27 result in higher costs to its customers.

28
29 **Q. How are OG&E customers benefitting from the design of the incentive**
30 **compensation plans?**

31 A. OG&E customers are benefitting directly from the results of the incentive compensation

1 plan design as evidenced by the more than 20 awards for operational excellence the
2 Company has received. The Company has received awards from organizations including:
3 Edison Electric Institute, JD Powers and Assoc., Electric Power and Light, American
4 Council of Engineering Companies, Market Strategies International and more. These
5 awards indicate that the Company is delivering operational excellence with respect to
6 innovation, efficiency and customer service.

7
8 **Q. Does the cost of STI increase the cost of service to OG&E's customers?**

9 A. No. As mentioned previously, if OG&E did not offer an annual incentive, the Company
10 would have to increase base salaries in order to provide market competitive
11 compensation levels to attract and retain talent. Incentive pay places a portion of
12 employee pay at risk, making it dependent on their performance and the Company
13 achieving its measures of Customer Satisfaction, Safety, EPS and Cost Management.
14 Customers experience the results of performance objectives at the Company level, so if
15 the Company does not perform well against these measures, the Company will not pay
16 out incentives for the measure that fell short of the mark. If the Company does pay out
17 incentives, this means that the Company has benefited customers with greater efficiency,
18 lower costs, healthier financial performance and improved reliability, safety and
19 compliance, which all translates to lower costs for customers. Incentive programs are
20 offered to drive behavior and increase productivity. The result is a more efficient and
21 effective business for customers.

22 23 **Summary**

24 **Q. Would you please summarize your perspectives to the Commission?**

25 A. Overall, the OG&E cash compensation program (base salary plus STI) is designed to be
26 competitive in the market (set at the market median), fiscally responsible to customers
27 and rate payers, and with variable pay tied to performance metrics that benefits
28 customers.

29 We have validated that the detailed annual market review process conducted by
30 OG&E staff ensures that the program remains competitive to attract and retain the
31 necessary talent to operate a cost effective and customer-centric utility. The

1 methodologies used are consistent with other best-in-class utilities.

2 The use of the STI program to both provide competitive compensation and focus
3 on strong performance for customers is a key ingredient to the Company's success. The
4 data indicate that without the STI, base salaries alone would be nearly 10% below the
5 market median cash compensation, which would jeopardize the Company's ability to
6 attract and retain key staff and would eliminate a key motivating force behind superior
7 customer service. As an integral part of the employee compensation package, 100% of
8 the STI program should be an allowable expense, in our opinion.
9

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

11 A. Yes.