GULF POWER COMPANY

Before the Florida Public Service Commission

Prepared Direct Testimony of

James M. Garvie

Docket No. 130140-EI

In Support of Rate Relief

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Q. Please state your name and business address.

A. My name is James Garvie. My business address is 30 Ivan Allen Jr. Boulevard, Atlanta, GA 30308.

Q. By whom are you employed?

A. I am employed by Southern Company Services (SCS) as Compensation and Benefits Director.

Q.What are your responsibilities as Compensation and Benefits Director for SCS?

A. I am responsible for leading the compensation, benefits, retirement and human resources operations functions for Southern Company and its affiliates including Gulf Power Company (Gulf or the Company). I have been in my current role since December 2011, when I joined SCS.

Q. Please describe your prior work experience and responsibilities.

A. Prior to joining SCS, I was a Director with The Alexander Group, a management consulting firm, where I advised management of Fortune 500 companies on a wide range of human resource issues. Before my position with The Alexander Group, I worked at BlueLinx, a large building

products distribution company, in a leadership position managing all aspects of sales, human resources, payroll and human resources information systems. Previous to that employment, I worked at Georgia-Pacific in increasing roles of responsibility in employee compensation and the accounting/finance area.

Q. What is your educational background?

A. I have a Masters of Business Administration degree from Kellogg School of Management at Northwestern University in Evanston, Illinois, and a Bachelor of Finance degree from the University of Incarnate Word in San Antonio, Texas. I am also a Certified Compensation Professional (CCP).

Q. Please describe your credentials as a compensation professional.

A. I have deep expertise and knowledge of compensation strategy, design and competitiveness gained through:

* Approximately fifteen years of direct and related compensation experience,
* 7 years in consulting across many industries, and
* Completion of a series of nine examinations to earn designation as a Certified Compensation Professional (CCP).

Q. In your experience as the SCS Compensation and Benefits Director and a CCP, is it customary to rely upon reports and studies prepared by compensation and benefit consulting firms?

A. Yes. Reports and studies prepared by recognized third-party experts are

commonly used and relied upon by corporate compensation and benefit experts to make decisions. Such studies are regularly used as a primary basis to determine the market level of compensation and benefits.

Q. Are you sponsoring any exhibits in this case?

A. Yes. I am sponsoring Exhibit JMG-1, Schedules 1 through 5. The information contained in Schedules 1 through 5 is true and correct to the best of my knowledge and belief, and except for Schedules 3 through 5 the Exhibit was prepared under my direction and control.

* Schedule 1, Gulf Power Company Fundamental Beliefs regarding Compensation and Benefits
* Schedule 2, Gulf Power Company Base Salary and Total Compensation to Market Median
* Schedule 3, Towers Watson Memorandum on Audit of Gulf Power Company’s Compensation Programs
* Schedule 4, Aon Hewitt Comparison of Employer-Paid Benefit Value
* Schedule 5, Towers Watson Comparison of Employer-Paid Benefit Value

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to outline Gulf’s customer-based fundamental beliefs on compensation and benefits, describe the design and market competitiveness of Gulf’s total compensation and benefits programs for our employees, set forth Gulf’s expense budget for employee compensation and benefits, justify Gulf’s 2014 benchmark variance for employee benefits, and demonstrate that the level of compensation and benefit costs requested in this case is reasonable, prudent, and necessary to enable Gulf to continue to provide safe and reliable electric service to our customers.

**I. GULF’S APPROACH TO**

**COMPENSATION AND BENEFITS**

Q. What are Gulf’s fundamental beliefs regarding compensation and benefits?

A. Gulf fundamentally believes that the design of compensation and benefit programs should support our customers’ need for safe and reliable electric service. Gulf takes a holistic approach to designing and valuing its compensation and benefit programs as a “total package.”

Gulf has developed four fundamental beliefs which serve as the foundation for the design and evaluation of our total package of compensation and benefits.

1. Long-term customer value is created through retaining employees.

* + Superior organizational performance is gained through attracting talent for the long-term and placing value on the knowledge, skills, and experience gained through longevity.

1. The health and well-being of the workforce improves productivity.

* A healthy workforce sustains employee commitment and top performance, which positively affects productivity and customer satisfaction.

1. Linking pay to performance efficiently and economically aligns employee and customer interests.
   * Placing a portion of employee compensation at risk drives our employees to achieve higher levels of performance, customer satisfaction, and productivity.
2. Compensation and benefits program competitiveness is critical.

* We must continuously evaluate our programs to ensure they are competitive to attract, engage, and retain employees, and that the programs are effective and financially sustainable.

Q. Please describe the benefits of evaluating Gulf’s compensation and benefits as a “total package”.

A. Evaluating compensation and benefits as a total package has two primary benefits:

1. Cost efficiency. Evaluating compensation and benefits as a whole allows Gulf to align valuable resources with the most important employee retention and attraction elements to gain maximum efficiency of resources. If compensation and benefits are evaluated as individual components, it can result in misalignment of elements and inefficient use of resources.
2. Retention and attraction of employees. Evaluating compensation and benefits holistically allows for the alignment of programs with Gulf’s need to attract, engage, and retain its highly skilled workforce.

Q. What are the components of Gulf’s total package of compensation and benefits?

A. The compensation portion of Gulf’s total package consists of base pay and at-risk pay. The benefits portion consists of health benefits, retirement benefits, and other benefits such as life and disability insurance. As shown on Exhibit JMG-1, Schedule 1, Gulf’s total package of compensation and benefits is aligned with its fundamental beliefs.

Q. How does Gulf measure the competitiveness of its compensation and benefits programs against the external market?

A. Gulf’s total compensation and benefits program is managed to the median of the external market. By managing to the median, we want to provide competitive compensation and benefits that will allow us to attract, engage, and retain qualified employees while also managing costs. Gulf utilizes recognized compensation and benefit consultants, such as Aon Hewitt and Towers Watson, to benchmark our compensation and benefit programs against the external market.

Q. What do you mean when you refer to managing Gulf’s total compensation and benefits package to the median of the external market?

A. Median or 50th percentile of the market represents the middle of the market

where half of the market is above and half is below. Gulf manages to the median of the market so that our total compensation and benefits are in the middle.

**II. TOTAL COMPENSATION**

Q. What is Gulf’s approach for designing employee compensation?

A. Our employee compensation is designed to provide total compensation that will allow us to attract, engage, retain, and competitively compensate employees based on individual and Company performance. The total compensation an employee receives is provided in the form of base pay and at-risk pay. Having total compensation provided in this form with a portion tied to performance has allowed Gulf to develop a culture of individual, team and customer accountability.

Q. Please describe the process for determining Gulf’s total compensation of base pay and at-risk pay.

A. We go through the following steps to determine total compensation:

1. Determine the median total target compensation for each position through the use of compensation surveys published by recognized third-party sources. Total compensation is comparable to what companies with whom we compete for talent offer their employees performing similar jobs with similar responsibilities and skill sets.
2. Based on the market, a portion of each individual’s total target compensation is subtracted and allocated to at-risk pay based on goals that benefit our customers, directly aligning individual compensation with customers’ interests. Positions with a greater influence over Company performance have a greater portion of total compensation that is allocated to at-risk pay.
3. Review the allocation of total compensation between base pay and at-risk pay to ensure it aligns with our fundamental beliefs.

Q. Why has Gulf chosen to provide total compensation in the form of base pay and at-risk pay?

A. Gulf has chosen to provide total compensation in the form of base pay and at-risk pay to emphasize performance and to align the interests of our employees with our customers. The table provided on page nine illustrates how a philosophy of providing total compensation in the form of base pay with no at-risk pay compares to Gulf’s philosophy of providing total compensation in the form of base pay and at-risk pay.

At Gulf, all employees have some portion of their total compensation that is at-risk and tied to the achievement of annual goals. Depending on the achievement level, the at-risk portion of their pay may be paid after the end of the year. It is not guaranteed to be paid each year. Employees with a greater influence over the long-term success of the Company have a larger portion of their total compensation at-risk, some of which is tied to the achievement of long-term goals. Based on the achievement level, lower goal achievement results in lower at-risk pay and higher goal achievement results in higher at-risk pay. An employee’s total compensation, which includes base pay and at-risk pay, will vary from year to year based on employee and Company performance.



Q. Is the use of base pay and at-risk pay to form an employee’s total compensation unique to Gulf?

A. Not at all. Providing total compensation in this manner is consistent with how utilities and general industry compensate their employees. We have

found that having total compensation provided in this manner has allowed

Gulf to develop a culture where our employees are consistently engaged with their work, focused on the customer, focused on the success of the Company, and driven to deliver the highest levels of customer service.

Q. What are the goals for the at-risk portion of total compensation?

A. Gulf’s at-risk pay goals are performance based and designed to align the employee’s interest with the customer’s interest. These goals provide balance between annual and long-term focus to benefit our customers. The annual goals include three categories that all serve to enhance Gulf’s service to customers - Gulf operational performance, Gulf return on equity performance and Southern Company earnings per share performance. Similarly, the long-term goals are also based on categories that serve to enhance Gulf’s service to customers beyond the current year into the future. As Gulf Witness Teel explains, there are benefits of focusing on the financial health of both Gulf and Southern Company, especially as they relate to investment and infrastructure improvements to meet our customers’ needs. Each of the at-risk pay goals are designed to focus employees on providing safe and reliable electric service to our customers.

Gulf’s operational goals focus employees on continually improving the Company’s operational performance for our customers. The goals focus employees’ attention on safety, customer satisfaction, generation availability, transmission and distribution reliability and company culture. Safety is measured to ensure the protection of employees, customers and communities; customer satisfaction is important to ensure that our customers are satisfied with the level of service we provide and our employees are striving to improve the customer experience; generation availability and transmission and distribution reliability are important to ensure the availability of power from our generation fleet and the reliable delivery of that power to our customers; and culture is measured to ensure that we are developing and diversifying our workforce to reach their full potential in an atmosphere of customer service and safety.

Gulf’s return on equity goal focuses employees on being efficient with Company resources and continually looking for ways to improve Gulf’s overall business. By employees working to keep expenses down, whether through efficient purchasing practices, budget management, or effective use of personnel resources, customers benefit through lower rates and the Company’s ability to attract investment. Employee work on economic development efforts and in the community similarly benefits customers through economic growth, community stability and improving Gulf’s financial performance.

Gulf’s earnings per share goal focuses employees on running the Company efficiently, not only as a stand-alone utility, but also as part of the Southern Company. This goal is a testament to the advantage of Gulf being a part of Southern Company. In their normal course of business, Gulf employees have access to specialized expertise and bulk purchasing leverages due to Gulf’s relationship with Southern Company. If Gulf had to purchase or hire this expertise as a stand-alone utility, these costs would likely be greater. Gulf employees’ ready access to this expertise and purchasing leverage helps better provide safe and reliable electric service to our customers.

First-line supervisors and above have a greater influence over the long-term success of the Company. Therefore, they have not only a larger proportion of their total compensation at-risk, but also some of their total compensation tied to the achievement of long-term goals. These long-term goals are stated in terms of total shareholder return which focuses employees on planning and managing Gulf’s resources efficiently in the short and long term.

First-line supervisors and above are encouraged through these goals to take a whole-company approach to their areas of responsibility. It is in our customer’s best interest to drive our employees to achieve long-term goals. Well executed long-term planning, budgeting and implementation benefits our customers through better reliability, efficiency and value now and in the future.

Q. Has Gulf’s total compensation program been effective in attracting, engaging and retaining the workforce?

A. Yes. The design of our total compensation program provided in the form of base pay and at-risk pay has been effective in allowing us to attract, engage, and retain our highly qualified workforce. It has enabled us to develop a culture where the customer is at the center of everything our employees do. Our employees are held accountable and know that the total compensation they receive depends on their performance in achieving goals that are focused on our customers. If the goals are achieved, then they will be compensated appropriately. If the goals are not met, their total

compensation will be less, which is also appropriate. While the program

has been effective, Gulf faces challenges with its workforce and attempting to keep our costs down.

Q. What are some of the workforce challenges that Gulf faces?

A. Gulf’s employees operate our company in an exceptional manner as recognized by our customers. A skilled, trained, and engaged workforce is essential for Gulf to continue to provide customers with safe and reliable electric service.

A huge challenge for Gulf and the utility industry overall is an aging workforce. The average age of our employee is 45 years old with 17 years of service within the Southern electric system. Over 39 percent of our employees are eligible to retire today. Our workforce has maintained and operated our generation and distribution business at the highest levels and has continually and actively worked to maintain a high level of customer satisfaction. Their hard work and customer focus have helped keep Gulf’s overall customer satisfaction level in the top quartile of the Customer Value Benchmark Survey for over 10 years, as described by Gulf Witness Strickland. These are also the highly skilled and trained employees who help train and transfer their knowledge to our less experienced employees to ensure continued reliable electric service to our customers into the future. With our aging and retirement eligible workforce, it is crucial for Gulf to both retain its current qualified employees and to be in position to compete in the job market for new employees.

A shortage of available workers in the external market with the requisite qualifications and skills is another challenge. It takes 5 to 7 years of in-house training and apprenticeship programs to reach the journeyman level of expertise required for our highly technical positions such as Line Technician, Substation Technician, or Plant Equipment Operator. Each year Gulf invests over 53,000 hours to grow and maintain the skills of our employees. This reflects an investment of approximately $2.5 million to ensure our employees have the skills required to safely perform the complex and hazardous work it takes to ensure that our customers receive safe and reliable electric service. With the shortage of qualified workers in the external market and the technical training required, it is essential that Gulf retain its current highly trained employees and be able to attract new employees in the job market.

Loss of employees to competitors is another serious challenge. With a shortage of qualified workers in the external market and the time and expense it takes to train employees, our experienced, well-trained and customer-oriented employees are targets of opportunity for other employers. The level of training, experience, and customer service focus of our employees is recognized in the industry and makes them highly marketable to other utilities. It is critical that Gulf is able to retain its current highly skilled workforce.

To meet these challenges, it is essential that adequate funds be available to support our total compensation and benefits package so that we can continue to attract, engage, and retain employees who continue to provide high levels of customer service and satisfaction today and into the future.

Q. What is Gulf’s total projected compensation expense for 2013 and 2014?

A. As shown on MFR C-35, Gulf’s 2013 projected total compensation expense is $120,774,735, and Gulf’s projected total compensation expense for 2014 is $123,981,962. It should be noted that these are Total Company projections, so they include compensation recovered through adjustment clauses and other compensation removed by Gulf Witness Ritenour’s net operating income (NOI) adjustments. The compensation reflected in Gulf’s operations and maintenance (O&M) request for the 2014 test year is $83,697,268.

Q. How does the total compensation projected for 2014 compare to the compensation projected for the 2012 test year used in Gulf’s last rate case?

A. The total compensation projection for 2014 of $123,981,962 is modestly higher than the total compensation projection of $119,797,482 in Gulf’s last rate case. It is an increase of 3.5 percent which is less than the rate of inflation between 2012 and 2014.

Q. How does Gulf’s total compensation of base pay and at-risk pay compare to the external market?

A. Gulf annually reviews its total compensation of base pay and at-risk pay to ensure that it is appropriately aligned with the external market. We use compensation data from external survey sources to benchmark our total compensation to the external market. These surveys are conducted by recognized third-party consulting firms, such as Towers Watson and Mercer, who collect compensation data from survey participants, aggregate

the data and provide participants with summary comparative data. As illustrated in Exhibit JMG-1, Schedule 2, when assessing both our base pay and total compensation of base pay and at-risk, Gulf is slightly below the median of the market. By maintaining total compensation relative to the median of the external market, Gulf helps ensure that it remains competitive while keeping compensation expense at reasonable levels.

Q. Has Gulf had the design and competitiveness of its compensation program reviewed by a third party?

A. Yes. Gulf had Towers Watson, a nationally recognized compensation and benefits firm, recently conduct a competitive assessment of its total compensation design (base pay and at-risk pay) relative to external market practice. Towers Watson’s conclusion is that Gulf’s compensation plans, programs, and processes are comparable to and competitive with the utility industry. Exhibit JMG-1, Schedule 3 summarizes Towers Watson’s analysis.

Q. Are Gulf’s total projected compensation of $123,981,962 for 2014 and projected compensation charged to O&M in the rate case of $83,697,268 reasonable and prudent?

A. Yes. The compensation portion of Gulf’s total compensation and benefits package is reasonable and prudent. These expenses and expenditures are

necessary to continue our efforts to attract, engage, and retain a highly trained and skilled workforce with a focus on our customers.

**III. TOTAL BENEFITS**

Q. Turning to the benefits portion of Gulf’s total compensation and benefits package, what is Gulf’s approach for designing its employee benefits program?

A. The benefits program is an integral portion of our total compensation and benefits package. Similar to our compensation program, Gulf’s benefits program is designed to align with our fundamental beliefs, specifically our beliefs that long-term value to the customer is created through retaining employees, that the health and wellbeing of the workforce makes a difference to productivity and customer satisfaction, and maintaining program competitiveness is critical to attract, engage, and retain our workforce. Offering a competitive but cost-efficient benefit program helps us attract and retain our highly skilled workforce. Our benefits program, including retirement and welfare plans, is designed to be valued at the median of the external market. We have intentionally designed a flexible benefits program that allows employees to choose those benefits that meet their individual needs. This approach provides the advantage of having the cost of many of the programs shared between the Company and our employees.

Q. What is Gulf’s projected benefit costs for the test year?

A. Total Benefit costs are projected to be $44,688,258 in 2014. The components are:

Health and Welfare benefits $ 14,738,651

Retirement Benefits

Pension Plan $ 11,500,000

Post-employment benefits $ 3,401,986

Employee Savings Plan $ 4,549,918

Total Retirement Benefits $ 19,451,904

Benefits Required by Law $8,530,500

Other Benefits $1,967,203

Benefits required by law include social security tax, federal and state unemployment taxes, and worker’s compensation. The benefits costs projected in O&M for the rate case are $25,945,198.

Q. How does Gulf’s benefits program compare to the external market?

A. We performed an assessment and found Gulf’s benefits program to be competitive against the utility industry and general industry. Aon Hewitt and Towers Watson conducted analyses of the benefit programs offered by Gulf and comparator companies in 2012, as can be seen in Exhibit JMG-1, Schedules 4 and 5, respectively. The analyses were done using Aon Hewitt's Benefit Index® and Towers Watson’s BENVAL database surveys. These tools compare the relative worth of one company's benefits program to those offered by a group of other companies. Based on both the Aon Hewitt and Towers Watson assessments, the relative value of benefits Gulf provides its employees is at market.

Q. How were the benefit competitiveness assessments made?

A. The analyses performed by Aon Hewitt and Towers Watson utilize survey data to gauge the value of our benefits against utilities and the S&P Fortune 500. The surveys include all retirement income, death, disability, healthcare, and paid time off benefits offered to salaried hires. The actuarial value of each of the benefits is calculated to reflect what each program would be expected to pay during a year and the present value of the benefits new hires would be expected to earn during a year but receive in the future, like pension benefits. The same employee population and assumptions are used when measuring the values for each of the programs. This standardization assures that the differences in benefit values are attributable to plan designs. Finally, the value of Gulf’s benefits program is compared to the average of the values for the comparator group's programs to arrive at a relative value result reported by the surveys. A relative value of 100.0 would be assigned if Gulf’s benefit value equaled the average value of the benefits offered by the comparator companies.

Q. Please describe the relative value of Gulf’s benefits program as compared to the external market as found by Aon Hewitt and Towers Watson.

A. Exhibit JMG-1, Schedule 4 contains a chart showing Aon Hewitt’s analysis of the relative value of Gulf’s benefits versus the average of two comparator groups. In addition, the chart shows the distribution of the relative values of comparator companies around the average. Exhibit JMG-1, Schedule 5 illustrates the relative value analysis completed by Towers Watson. As this exhibit shows, Gulf’s benefits are below the average value of benefits provided by utilities. Using the Aon Hewitt Benefits Index, Gulf is 96.1 percent compared to utilities. Using Towers Watson’s BENVAL Gulf is 96.2 percent compared to utilities.

Q. Are Gulf’s 2014 total benefits costs of $44,688,258 and projected O&M benefits expenses of $25,945,198 reasonable and prudent?

A. Yes. The benefits portion of Gulf’s total compensation and benefit package is indeed reasonable and prudent. These expenses are necessary to continue our efforts to attract, engage, and retain qualified employees with a focus on customer service.

Q. Is Gulf’s projected level of benefits expense for 2014 representative of future periods?

A. Yes.

**IV. PENSION COSTS**

Q. Mr. Garvie, Gulf Witness McMillan testifies that Gulf’s Administrative and General (A&G) operations and maintenance expense benchmark variance exceeds the O&M benchmark by $11,023,000. Gulf Witness Erickson testifies that you will justify the benchmark variance of $5,871,000 in the area of pension costs. Please address why pension expenses have grown at a faster rate than the consumer price index and customer growth since Gulf’s last rate case.

A. The reasons for increased pension expenses are not unique to Gulf. The simplest answer is that they have increased because of requirements of the Financial Accounting Standards Board (FASB). The FASB has very specific requirements governing pension accounting, and compliance with these requirements is not discretionary.

The primary factor for the increase in pension expenses is the decrease in the required interest rate used to measure benefit obligations, which in this context are typically called liabilities. The FASB requires plan sponsors to measure plan liabilities annually based upon current market interest rates. The qualified and non-qualified pension plans weighted average rate for the 2014 test year is 4.27 percent. The rates used to measure the 2011 and 2012 pension expenses were 5.53 percent and 4.98 percent, respectively. This decline in the required FASB interest rate has increased plan liabilities by $25 million, or 7.6 percent, from year end 2010 to year end 2011 and an additional $39 million, or 10.6 percent, from year end 2011 to year end 2012.

The secondary factor contributing to the increased expense includes a decrease in the assumed rate of return to reflect a decline in the financial markets. The assumed rates of return (net of investment-related expenses) used to measure 2011 and 2012 pension expense were 8.45 percent and 8.20 percent, respectively. For the 2014 test year, the assumed rate of return (net of investment-related expenses) is 8.20 percent. Therefore, we have seen a decrease in the assumed rate of return over the past 4 years (2011-2014) of 25 basis points.

The pension expense variance of $5,871,000 is the combined result of all of these factors and results in an O&M benchmark variance.

**V. LONG-TERM AT-RISK COMPENSATION**

Q. Who are the Gulf employees that have a portion of their at-risk compensation tied to long-term performance?

A. Gulf employees who have the most responsibility for decisions that impact the long-term success of the Company have a portion of their at-risk compensation tied to long-term performance. This group of employees extends beyond executive management. It includes managers, most first-line supervisors and key individual contributors that through the decisions they make in their job impact the long-term success of the Company.

It is this group of employees that not only have Company historical knowledge, but also assist in creating and implementing the vision of how we serve our customers both now and in the future. They maintain the employee’s focus on the customer, make difficult decisions on the allocation

of resources, and drive results. They are responsible for how employees

serve our customers and deliver safe and reliable electric service.

Currently, there are some 121 Gulf employees who have an element of long-term at-risk compensation. It is critical that we retain these employees and provide competitive compensation that includes long-term at-risk compensation.

Q. Why does Gulf consider it critical to retain these employees and provide competitive compensation?

A. Gulf works hard to attract, train and retain all its employees. There is a considerable investment in training employees and there is tremendous value to the customer to retain employees that have the knowledge and experience to run the Company efficiently and effectively. The employees who receive long-term at-risk compensation provide Gulf, and its customers, a wealth of experience, knowledge and skill. They make the tough decisions that result in quality of service, organize and optimize resources, understand the importance of keeping the customers as our top priority, and know how to motivate others to perform for the customer.

Q. If this group is so dedicated to Gulf and its customers, why do they need competitive compensation that includes long-term at-risk compensation?

A. No well-managed company that has developed a culture of customer service and orientation can maintain such a culture if it takes advantage of those who have the greatest responsibility for leading the organization. In the short-term, people who have shown dedication to the Company may

make sacrifices for the organization, but in the long-term, the Company

must provide competitive compensation including long-term at-risk compensation or these employees will seek employment alternatives elsewhere.

For employees who receive long-term at-risk compensation, there are a number of attractive alternatives. The companies with whom we compete for these employees offer competitive compensation packages and these employees are attracted by a compensation structure that rewards superior long-term performance. Unless Gulf has a competitive compensation structure, Gulf runs the risk of losing the employees who have the most responsibility for assuring Gulf’s long-term performance to its customers.

Q. Mr. Garvie, beyond making Gulf competitive with other companies that compete for these employees, what is the importance of long-term at-risk compensation for this group of employees?

A. This pay for performance element focuses on a long-term rather than a short-term element of performance. All Gulf employees have short-term at-risk compensation. This is consistent with our fundamental belief that compensation should be tied to performance. However, if the sole focus on performance is short-term, then there are risks that short-term decisions may be made to improve short-term performance that would have adverse longer term consequences. So, for the employees who have more responsibility for decision-making, Gulf intentionally includes an element of

long term at-risk compensation so that short-term decisions will not out-weigh longer-term considerations.

Q. Mr. Garvie, please summarize your understanding of how the Commission treated Gulf’s at-risk pay in the last rate case?

A. In its last rate case, Gulf requested Total Company compensation of

$119,797,482. The at-risk or variable compensation portion of total compensation was $16,464,470. Intervenors argued that all at-risk, or what they called “incentive,” compensation should be disallowed. Instead, the Commission disallowed only $2,348,255 of at-risk compensation.

In this $2,348,255 disallowance of at-risk compensation, there are two identifiable components. A very small portion of the short-term at-risk compensation (the Performance Pay Program or PPP) associated with the vacancy adjustment was disallowed and the Commission disallowed all long-term O&M compensation expenses. Together, these two disallowances of at-risk compensation elements were $2,348,255 on a Total Company basis and $2,301,505 on a jurisdictional basis.

From the Commission’s order, the seemingly deciding factor that led to the disallowance of the long-term compensation was that even with the removal of long-term compensation from employees who were eligible for long-term compensation, this group of Gulf employees were below but closer to the median market salary than Gulf’s Covered (union) employees:

After removing the long-term incentive pay, salaries for Pay Grades 7 and above are still within a reasonable range. Based on witness Kilcoyne’ testimony regarding the External Market Analysis as of September 2011, page 1 of 2, the average target salary for Pay Grade 7 and above including base salary plus only the short-term incentive compensation is $159,105 which is 5 percent above the median market of $151,582.

Comparing the $159,105 target base salary plus short-term incentive compensation to the market salary including the market median base plus the short-term median target and long-term median target compensation of $169,076 shows that the $159,105 salary is only 5.9 percent below the median market target. In comparison, the evidence shows Gulf’s Covered employees’ target salaries are 7.5 percent below the median market salary and Gulf’s employees in Pay Grades 1 through 6 target salaries are 3.5 percent below the median market salaries. Even after removing the long-term compensation from the employees in Pay Grades 7 and above, these employees’ salaries will still be at a reasonable level as compared to other Gulf employees’ salaries and to the median market salaries. Order No. PSC-12-0179-FOF-EI at 96-7.

Q. Mr. Garvie, as an expert on compensation matters, what, if any, concerns do you have regarding the Commission’s discussion of long-term at-risk compensation in Gulf’s last rate case?

A. Looking at the two paragraphs quoted above, I have two concerns. First, a

comparison of the group of Gulf’s employees who are eligible for long-term at-risk compensation with other groups of Gulf employees who are not eligible, particularly employees who are union employees, is simply not a valid comparison. Second, moving the target compensation level for any group of employees by more than 10 percent would be counterproductive and reducing it from slightly above the market median to below market for this group of employees would be particularly counterproductive.

Q. In regard to your first concern, it was Ms. Kilcoyne’s exhibit that showed each of these groups of employees relative to the market median. How can you say it is inappropriate to compare one group to the other?

A. The purpose of the comparison in this or any other compensation market assessment is between the group in question and the market median. What we are attempting to discern is how Gulf’s compensation for a particular group of Gulf employees compares to other similar positions in the market. We are not measuring how the compensation of various groups of Gulf employees compares to each other due to the fact that the skills to perform the jobs in each group may not be comparable. The goal is to appropriately compare the responsibilities of each position to similar positions in the market in order to appropriately compensate employees compared to our competitors for talent in the market.

Q. In regard to your second concern, what was the import of moving the compensation target for employees eligible for long-term compensation by 10.9 percent?

A. Such a decision immediately makes Gulf less attractive to this critically important group of employees. It removes the only element of compensation that is designed to encourage long-term considerations, reduces total compensation by almost 11 percent, and moves the compensation level for this group from slightly above market to below market. In short, it makes Gulf far less competitive and challenges Gulf’s ability to retain the employees it needs most to maintain its customer accountability. It increases Gulf’s prospects of losing these employees, who provide a wealth of experience, knowledge, and skill in providing safe and reliable electric service to our customers.

Q. But, Mr. Garvie, the Commission did not say Gulf could not pay this type of compensation; it only said that this type of compensation would not be included in rates. Couldn’t Gulf continue to pay this type of compensation if it is so important?

A. Long-term at-risk compensation is a legitimate and necessary cost of providing service to customers. It is intentionally designed into the compensation program for a group of employees that are critical to the long-term success of the Company and through their judgment and decisions could have a major impact on the customer. It is very important for Gulf to be able to attract and retain this group of employees. My limited understanding of ratemaking is that it is intended to cover the reasonable costs of delivering service. These costs are reasonable; indeed, they are necessary and desirable, and I see no value in suggesting they no longer be paid by disallowing them for ratemaking purposes.

Q. What were the specific long-term at-risk compensation programs for which the costs were disallowed in Gulf’s last rate case?

A. The three long-term at-risk compensation programs for which rate recovery was disallowed were Gulf’s Stock Option Expense, Performance Share Program, and Performance Dividend Program.

Q. Please describe Gulf’s stock option program.

A. Employees with a greater influence over the long-term success of the Company receive a portion of their at-risk pay in the form of stock options. Employees receive a grant of stock options with an exercise price equal to the closing price of Southern Company stock on the date the options are granted. The stock options vest or become exercisable over a three-year period. The value of stock options is recognized when the current Southern Company stock price exceeds the exercise price on the date the options were granted. If the current stock price is higher than the exercise price, there would be a gain recognized. If the current stock price is lower than the exercise price, then the stock option has no value.

Q. Please describe Gulf’s performance share program.

A. Like stock options, employees with a greater influence over the long-term success of the Company receive a portion of their at-risk pay in the form of performance shares. Employees receive a grant of performance shares at the beginning of a three-year performance period. Southern Company’s total shareholder return (TSR) relative to the TSR of peer utilities is ranked at the end of the three-year period. Depending on Southern Company’s TSR ranking, employees may receive 0 percent to 200 percent of the

performance shares granted at the beginning of the period in actual shares of Southern Company stock.

Q. Please describe Gulf’s Performance Dividend Program.

A. This program is no longer a part of Gulf’s total compensation plan. There were some costs associated with the plan in Gulf’s last rate case, but there are no projected costs for the program in this rate case.

Q. Mr. Garvie, in light of the Commission’s disallowance of long-term at-risk variable compensation programs in the last rate case, why is Gulf seeking recovery for such programs in this case?

A. Based upon our understanding of the markets in which we compete for employees as well as the advice of recognized third-party compensation consultants, Gulf needs these two long-term at-risk compensation programs to be market competitive. Other utilities and other major employers with whom we compete for employees use such programs. Gulf would be at a competitive disadvantage in attracting, engaging, and retaining employees if we did not offer comparable programs.

Compensation competitiveness aside, this is highly desirable compensation element for this group of employees, who have more impact on customer service and satisfaction than any other employees. A real advantage of an at-risk compensation program that has elements of both short-term and long-term financial performance goals is that it does not drive employees to make short-term economic decisions that have potential adverse long-term economic consequences. Driving employees to cut costs in the short-term may increase costs that customers will have to pay in the long-term. That is why having an element of long-term at-risk compensation that focuses on financial performance benefits customers. Losing that element of compensation, particularly for employees who make both short-term and long-term decisions, is not in the customers’ interests.

Q. How, if at all, do Gulf’s long-term compensation programs align with Gulf’s fundamental compensation beliefs previously discussed?

A. These programs are consistent with our fundamental beliefs in designing our compensation and benefit programs.

1. Long-term customer value is created through retaining employees.

The employees eligible for these programs are critical to leading Gulf’s other employees to superior organizational performance. They gained their knowledge, skills, and experience, in part, through longevity. Retaining this expertise and record of success in serving customers is essential to Gulf being able to continue to provide high value to its customers.

1. Pay-for-performance alignment drives results.

The employees eligible for these long-term at-risk programs have more of their overall compensation at-risk than other employees whose performance does not have as great an impact on overall performance. We know that placing a portion of employee compensation at risk drives our employees to achieve higher levels of performance, customer satisfaction, and productivity. Making this element of compensation at-risk rather than including it in base pay ties compensation to performance and customer value.

1. Compensation and benefits program competitiveness is critical.

We know we must continuously evaluate our programs to ensure they attract, engage, and retain talented resources and that the programs must be effective and financially sustainable. The employees eligible for these two programs have opportunities at other utilities and other major employers to have the same types of at-risk compensation programs. If we fail to offer such programs, then we will have difficulty attracting and retaining these important employees.

Q. Why is it appropriate for these long-term, at-risk compensation programs to focus on Southern Company financial performance rather than Gulf financial and operational performance?

A. The employees to whom these programs are targeted already participate in Gulf’s short-term at-risk pay program that focuses on goals the Commission has found acceptable (including one Southern Company financial goal). These employees, which include managers, some first-line supervisors, and key individual contributors, have a greater effect on overall financial performance and customer satisfaction than others in the Company, so it is appropriate to place more of their compensation at-risk if they do not help produce positive financial results.

The real choice is not whether there should be a long-term financial focus as well as a short-term financial focus. It is clear that there needs to be an element of both so that short-term decisions do not adversely affect longer-term decisions. The real issue is whether the longer-term focus should be on Gulf’s financial performance or the financial performance of its parent, the Southern Company.

It is important for this group of leaders to understand not only that they serve Gulf’s customers, but also that they are part of a larger whole. They need to know when it makes sense to customers for Gulf to call on system-wide resources instead of just Gulf resources, understand system economies of scale when serving Gulf’s customers, and understand that the achievement of Southern Company financial goals enables Gulf to serve its customers. The Commission recognized this very concept when approving the Southern Company financial goal in allowing short-term at-risk compensation costs in Gulf’s last rate case: “We recognize that the financial incentives that Gulf employs as part of its incentive compensation plans may benefit ratepayers if they result in Gulf having a healthy financial position that allows the Company to raise funds at a lower cost than it otherwise could.” Order No. PSC-12-0179-FOF-EI at 94.

**VI. SUMMARY**

Q. Please summarize your testimony.

A. Gulf’s total compensation and benefits package benefits our customers by allowing us to attract, engage, and retain a highly trained, skilled, and customer focused workforce that delivers safe and reliable electric service. The design of our total compensation and benefit programs, including both short-term and long-term at-risk pay, is aligned with the median of the market. The costs of our compensation and benefit programs are both reasonable and prudent based on market comparisons and should be included in the rates paid by customers.

1. Does this conclude your testimony?

A. Yes.

AFFIDAVIT

STATE OF GEORGIA ) Docket No. 130140-EI

)

COUNTY OF FULTON )

Before me the undersigned authority, personally appeared James M Garvie, who being first duly sworn, deposes, and says that he is the Compensation and Benefits Director at Southern Company Services and that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.

The signed original affidavit is attached to the

original testimony on file with the FPSC.

s/\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

James M. Garvie

Compensation and Benefits Director

Sworn to and subscribed before me this \_\_\_\_\_\_ day of \_\_\_\_\_\_\_\_\_\_, 2013.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Notary Public, State of Georgia

Commission No. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

My Commission Expires \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Gulf’s Total Package of Compensation and Benefits**

**Aligns with Fundamental Beliefs**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Fundamental Beliefs** | **Compensation Plan** | **Health Benefits Plan** | **Retirement Plans (Pension, 401k, Retiree Medical)** | **Other Benefits Plans (Life and Disability Insurance Plans)** |
| 1. Long-Term Customer Value is Created Through Retaining Employees | **Secondary** | **Secondary** | **Primary** | **Primary** |
| 1. Health and Wellbeing of the Workforce Improves Productivity | **NA** | **Primary** | **Secondary** | **Secondary** |
| 1. Linking Pay to Performance Efficiently and Economically Aligns Employee and Customer Interests | **Primary** | **NA** | **NA** | **NA** |
| 1. Compensation and Benefit Program Competitiveness is Critical | * **Annually review against the market for alignment** * **Annually review against the market for competitiveness** | | | |

**Primary represents a primary focus of plan design**

**Secondary represents a secondary focus of plan design**

**Gulf Power Company**

**Base Salary and Total Compensation to Market Median**

|  |  |  |
| --- | --- | --- |
|  | **Gulf Base Salary to Market Median Base Salary** | **Gulf Total Compensation to Market Median Total Compensation** |
| Gulf Power Company | -1.6% | -0.4% |

Notes: 1. Total Compensation includes base salary plus at-risk (variable) compensation.

2. Data does not include employees and positions covered by a collective bargaining unit

since base salary wages are negotiated.