

**BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 080317-EI**

**IN RE: TAMPA ELECTRIC COMPANY'S
PETITION FOR AN INCREASE IN BASE RATES
AND MISCELLANEOUS SERVICE CHARGES**



**REBUTTAL TESTIMONY AND EXHIBIT
OF
DIANNE S. MERRILL**

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3 **OF**

4 **DIANNE S. MERRILL**

5
6 **Q.** Please state your name, business address, occupation, and
7 employer.

8
9 **A.** My name is Dianne S. Merrill. My business address is 702
10 North Franklin Street, Tampa, Florida 33602. I am
11 employed by Tampa Electric Company ("Tampa Electric" or
12 "company") as Director, Staffing and Development.

13
14 **Q.** Are you the same Dianne S. Merrill who filed direct
15 testimony in this proceeding?

16
17 **A.** Yes I am.

18
19 **Q.** What is the purpose of your rebuttal testimony?

20
21 **A.** The purpose of my rebuttal testimony is to address
22 serious errors and shortcomings in the prepared direct
23 testimonies of Helmuth W. Schultz, III, testifying on
24 behalf of the Citizens of the State of Florida and Jeffry
25 Pollock, testifying on behalf of the Florida Industrial

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Power Users Group.

Q. Have you prepared an exhibit supporting your rebuttal testimony?

A. Yes I have. I am sponsoring Rebuttal Exhibit No. __ (DSM-2), consisting of two documents, prepared by me or under my direction and supervision. These consist of:
Document No. 1 2007 BENVAl Study - Defined Contribution
Document No. 2 2007 BENVAl Study - Defined Benefit and Defined Contribution

Q. Please summarize the key concerns and disagreements you have regarding the substance of Messrs. Schultz and Pollock's testimony.

A. My key concerns and disagreements with Messrs. Schultz and Pollock's testimonies relate to their conclusions that 1) certain costs in the company's incentive compensation plan should be excluded, 2) the 401(k) fixed match expense should be reduced, and 3) stock compensation should be excluded from cost of service.

Q. What is Tampa Electric's compensation philosophy?

1 **A.** Tampa Electric's philosophy is to provide a compensation
2 system that aligns with business strategies and offers
3 competitive rewards for outstanding accomplishments
4 toward the success of the organization. Total
5 compensation is designed to be competitive so that the
6 company can attract and retain the most qualified
7 individuals.

8
9 **Q.** Please describe Tampa Electric's compensation plan.

10
11 **A.** For all employees of Tampa Electric, there are two parts
12 of compensation; base salary, which is the fixed portion
13 of total compensation and short-term incentive, which is
14 the cash portion of compensation that is "at risk". The
15 company targets total compensation at the 50th percentile
16 when comparing external market data to similar company
17 positions.

18
19 For officers and key employees, there is a third
20 component, long-term incentive, which is the equity
21 portion of total compensation. The company considers
22 these components to be key elements of its total rewards
23 plan, which also includes other benefits such as health
24 care and life insurance benefits. Each of these
25 components plays an important role in enabling Tampa

1 Electric to remain competitive with other companies
2 seeking to attract similarly qualified employees.

3
4 **Q.** Please describe the company's three short-term employee
5 incentive plans.

6
7 **A.** Tampa Electric has three types of incentive plans; an
8 officer short-term incentive plan, a key employee short-
9 term incentive plan, and a general employee short-term
10 incentive plan known as Success Sharing.

11
12 The officer's short-term incentive plan provides a
13 consistent framework for applying annual incentive pay to
14 officers of Tampa Electric. Each participant is assigned
15 a target award amount, expressed as a percentage of
16 annual base salary. The target award levels are
17 established at a level that, when combined with each
18 participant's base salary, provides a competitive total
19 cash compensation opportunity. The incentive portion
20 reflects compensation "at risk" which is directly related
21 to performance and results achieved. Performance is
22 measured, in part, against a combination of quantifiable
23 financial and operational goals. Each participant has a
24 "business plan" goal, which reflects the participant's
25 contribution to achieving initiatives in support of the

1 business plan and overcoming any business changes by
2 mitigating the impact of unexpected adverse business
3 developments or enhancing profitability through effective
4 management initiatives beyond the business plan.

5
6 The key employee short-term incentive plan works
7 virtually identically to the incentive plan for officers.
8 As with officers, key employees have both financial and
9 operational goals.

10
11 The general employee short-term incentive plan is known
12 as Success Sharing and it is available to all other
13 employees working at least 20 hours per week. For 2008,
14 the plan is comprised of customer-focused operational and
15 financial goals. The maximum payout percentage is
16 applied to the higher of the employee's total earnings or
17 job market value for the calendar year.

18
19 The incentive plans put a portion of employees'
20 compensation "at risk". This means that if performance
21 goals are not met, the payout is not made. If certain
22 performance results are achieved, a predictable award
23 will be earned based upon objective criteria. The actual
24 amount of the award depends upon the achieved results.

25

1 All of the incentive plans are designed to emphasize key
2 operational and financial goals; link pay with business
3 performance and personal contributions to results;
4 motivate participants to achieve high levels of
5 performance; and reinforce desired business behaviors and
6 results. Incentive plans such as these encourage cost
7 control and resource optimization, both of which benefit
8 customers. While there is no empirical evidence to
9 support it, the company attributes its incentive plans to
10 helping manage costs for so long without a base rate
11 increase and to performing favorably under the
12 Commission's O&M benchmark.

13
14 **Q.** On page 7, lines 1 through 3 of his direct testimony, Mr.
15 Schultz claims that the company has failed to document
16 the need to include incentive pay above employee base
17 salaries to retain or motivate its employees. Do you
18 agree?

19
20 **A.** No, I do not agree. Incentive pay is a key component of
21 total compensation. The company uses market data and
22 benchmarking results for similarly situated companies to
23 measure the competitiveness of its compensation. In a
24 time when the electric industry is facing workforce
25 challenges while numerous industry-wide initiatives are

1 required, it is critical for Tampa Electric to attract
2 and retain talented individuals. Its total compensation
3 plan, including incentive compensation, is designed to do
4 so.

5
6 **Q.** How does the company determine reasonable and appropriate
7 compensation levels?

8
9 **A.** The company uses market data and benchmarking results to
10 measure the competitiveness of its compensation. For
11 each company position, it matches essential job functions
12 to those found in external market surveys. These same
13 surveys show that incentive compensation programs like
14 Tampa Electric's are commonly used by similarly situated
15 companies. Based on the *World At Work 2008/2009 Annual*
16 *Salary Budget Survey*, over 80 percent of the 2,375
17 companies surveyed use an incentive pay program.

18
19 Incentive compensation plans are not new. In fact, Tampa
20 Electric's Success Sharing plan has been in place since
21 1990 and its appropriateness was approved by the
22 Commission in the company's last rate case in 1992. In
23 Gulf Power Company's ("Gulf") most recent base rate
24 proceeding (Docket No. 010949-EI), Mr. Schultz made
25 similar arguments about their incentive compensation plan

1 as he does about Tampa Electric's, but the Commission did
2 not agree with him and made no adjustment. The
3 Commission noted that Gulf offers a plan consisting of
4 base salary and incentive compensation and that only
5 receiving a base salary would mean Gulf employees would
6 be compensated below employees at other companies. While
7 I am not familiar with the details of their plan, their
8 approach to utilize market data appears to be similar.
9 One apparent difference is that Gulf's philosophy is to
10 pay employees at the 75th percentile while Tampa
11 Electric's is to target the 50th percentile.

12
13 **Q.** Would Tampa Electric need to consider restructuring its
14 total compensation package if any incentive compensation
15 expenses were excluded?

16
17 **A.** Yes. Tampa Electric would need to consider raising base
18 salaries while decreasing or eliminating the "at-risk"
19 incentive compensation component. It is inappropriate to
20 single out the incentive component of an employee's total
21 compensation for scrutiny just because it is called
22 "incentive" compensation. Tampa Electric's total
23 compensation package, including the portion that is
24 contingent on achieving incentive goals, is set near the
25 median level of benchmarked compensation, which is the

1 relevant level of cost that should be considered for
2 ratemaking purposes. Accepting Mr. Shultz's
3 recommendation to disallow incentive compensation would
4 adversely affect the company's ability to compete in
5 attracting and retaining a high quality and skilled
6 workforce. Otherwise, total compensation would be below
7 the median for comparable jobs. Under this scenario, it
8 would not be reasonable to expect that the company could
9 continue to attract and retain quality employees.

10
11 Using incentive compensation programs is less costly than
12 increasing base salaries because incentive compensation
13 is "at risk" and, by definition, not guaranteed. The "at
14 risk" component motivates employees to perform at high
15 levels and results in more efficiency, which translates
16 to direct benefits for the company's customers.

17
18 **Q.** On page 7, lines 13 and 14 of his direct testimony, Mr.
19 Schultz claims that the goals set by the company and the
20 determination of eligibility payments under the plan are
21 seriously flawed, particularly from a ratemaking and
22 ratepayer prospective. Do you agree?

23
24 **A.** No. Although it is not clear from Mr. Schultz's
25 testimony which plan he is referencing, his examples

1 relate to Success Sharing goals. The goals are
2 established each year to focus the organization on the
3 most important customer-oriented operational and
4 financial challenges. The goals are designed to be
5 measurable and attainable but still represent a
6 significant challenge to achieve. The goal setting
7 process includes a review of historical results and
8 achievements, the challenges of the goal and the
9 applicability to the upcoming year's operational and
10 financial objectives. The goals are set to have a
11 reasonable chance of achievement while requiring efforts
12 that challenge the organization's employees and balance
13 the cost to provide targeted levels of service. The
14 goals have been appropriately set and have helped Tampa
15 Electric accomplish overall operational and financial
16 objectives over the years.

17
18 **Q.** Describe in more detail how Success Sharing goals are
19 currently structured.

20
21 **A.** The maximum annual payout under Success Sharing is 12
22 percent; five percent is tied to customer-focused
23 operational goals, five percent is tied to Tampa Electric
24 net income, and two percent is tied to TECO Energy net
25 income. The two net income goals are self-funding.

1 Tampa Electric witness Jeffrey Chronister describes what
2 is meant by "self-funding" in his rebuttal testimony.

3
4 **Q.** Mr. Schultz asserts the company's operational goals and
5 targets, specifically related to customer favorability,
6 SAIDI, safety and environmental, are set so that
7 employees are not required to improve performance in
8 order to receive payout. How do you respond to this?

9
10 **A.** As I stated above, the goals are set to have a reasonable
11 chance of achievement but require focus on all employees'
12 parts and require them to achieve high levels of
13 performance given all of the other operational and
14 financial challenges before them. The targets and goals
15 are not driven by continuous improvement as Mr. Schultz
16 suggests they should be but instead are focused on
17 providing quality service for customers. If the goals
18 and targets were set to focus on continuous improvement
19 year over year, the cost of providing service would be
20 significantly higher than what the company is currently
21 proposing in this proceeding.

22
23 The goal setting process is not taken lightly by the
24 company and there are numerous factors that go into
25 setting goals and targets each year, including past

1 achievements, organizational changes, and system
2 enhancements. In the rebuttal testimony of Tampa
3 Electric witness Regan Haines, he explains the types of
4 factors that have impacted the SAIDI goal over the past
5 years.

6
7 **Q.** On pages 9 and 10 of his direct testimony, Mr. Schultz
8 claims that the company failed to achieve its target for
9 five of the seven Success Sharing goals in 2003. He also
10 claims that two of seven goals were not achieved in 2004,
11 five of seven goals were not achieved in 2005, two of
12 seven goals were not achieved in 2006 and two of seven
13 goals were not achieved in 2007; yet, despite the fact
14 that goals were not achieved in each of the five years,
15 the company still expensed and paid 18 to 49 percent more
16 than the target level of incentive compensation budgeted
17 during the years 2004 through 2007. Is this true?

18
19 **A.** It is unclear what data Mr. Schultz used to derive his
20 conclusion, but his assertion is incorrect. For 2002 and
21 2003 when eligible employees could earn up to 10 percent
22 incentive compensation, payout was 9.25 to 10 percent and
23 3.83 to 4.43 percent, respectively. For 2004 through
24 2007 when the maximum achievement was 12 percent, actual
25 payout was 4.94 percent, 6.03 percent, 4.86 percent and

1 6.41 percent, respectively.

2
3 **Q.** Mr. Schultz also asserts that the 2005 Success Sharing
4 results showed that the company failed to meet five of
5 seven targets (safety, environmental, SAIDI, cost
6 recovery clauses, and Tampa Electric net income), yet its
7 incentive compensation expense was more than 49 percent
8 above the target incentive amount. Is this true and if
9 so, does it mean that the incentive plan is flawed or
10 that the related costs should be excluded from the
11 company's cost of service?

12
13 **A.** No, it is not true. In 2005, when the maximum
14 achievement was 12 percent, the payout was only 6.03
15 percent. The incentive plan is not flawed and the costs
16 related to the plan are appropriately included in
17 calculation of the company's revenue requirement for the
18 test year.

19
20 **Q.** On page 12, lines 6 through 8 of his direct testimony,
21 Mr. Pollock claims that any Success Sharing "payout to
22 all participants is zero if TECO Energy's income
23 threshold set for that year by the Compensation Committee
24 is not achieved." Is this correct?

25

1 **A.** No. The Success Sharing payout is not contingent upon
2 TECO Energy achieving certain financial goals. If the
3 TECO Energy net income goal is not met, two percent of
4 the eligible 12 percent is not paid.

5
6 **Q.** Messrs. Pollock and Schultz assert that only 50 percent
7 of the Success Sharing payout should be included in
8 operating expenses because both shareholders and
9 ratepayers benefit equally. Do you agree?

10
11 **A.** No, I do not agree. The Success Sharing operational and
12 financial performance measures are heavily weighted
13 toward providing benefits to customers. They promote
14 safety, reliable service, cost containment and financial
15 soundness of Tampa Electric among other things. The
16 entire amount of this program should be allowed because
17 it is designed to achieve favorable customer results.

18
19 **Q.** Describe in more detail how the 2008 officer and key
20 employee short-term incentive plan goals are structured.

21
22 **A.** Tampa Electric officers' short-term incentive plan
23 consists of 60 percent financial and 40 percent
24 operational goals. Two thirds of the financial goals are
25 focused on Tampa Electric net income with the remainder

1 on TECO Energy results. For key employees, 50 percent of
2 their goals are operational and 50 percent are financial.
3 Seventy percent of the financial goals are focused on
4 Tampa Electric net income with the remainder on TECO
5 Energy results.

6
7 **Q.** Mr. Pollock recommends 100 percent disallowance of
8 officer and key employee short-term incentive plan
9 expense because "those payments are contingent upon TECO
10 Energy achieving a specific level of net income." Is he
11 correct and is his recommendation appropriate?

12
13 **A.** He is not correct and the recommendation is not
14 appropriate. While officers' payout is contingent upon
15 TECO Energy achieving certain financial results, key
16 employee payout is not and the overall focus of both
17 programs remains on Tampa Electric's operational and
18 financial results. Participants in these plans help
19 ensure the company's goals of providing customers with
20 safe and reliable service. The participants also focus
21 on ensuring an adequate return to shareholders. Both of
22 these objectives benefit the ratepayers. The first
23 directly benefits ratepayers who rely on electric service
24 to meet their needs and the second indirectly benefits
25 ratepayers by having a company that is able to attract

1 needed capital at a reasonable cost to provide safe and
2 reliable service. If the Commission were to agree with
3 Mr. Pollock on a policy basis, which it should not, the
4 amount of incentive compensation expense included in the
5 2009 test year associated with TECO Energy's financial
6 performance is only about eight percent, not 100 percent
7 as he proposes. Mr. Chronister addresses this in more
8 detail in his rebuttal testimony.

9
10 **Q.** Please describe the company's long-term incentive
11 compensation plan.

12
13 **A.** The company's long-term incentive plan is another
14 component of officers' and key employees' total
15 compensation packages. Through stock awards, the
16 company's plan is designed to reward long-term company
17 and individual success and, as such, it is used as a
18 retention tool. For eligible employees, the company
19 awards a mix of 70 percent performance and 30 percent
20 time-vested restricted shares based on an annual market
21 review conducted by outside consultants that compares the
22 value of the grants to salary levels to determine the
23 appropriate award amounts. The company's performance
24 must be strong and employees must remain employed by the
25 company for the duration of the vesting period to be

1 eligible for any possible payout.

2

3 For performance restricted shares, the company's
4 performance is measured against a set of peer companies.
5 The performance measurement period is three years and the
6 award depends on the company's total return as compared
7 to other peer companies. Performance-based restricted
8 stock vests anywhere from zero to 150 percent of the
9 grant amount.

10

11 Unlike performance restricted shares, time-vested
12 restricted shares are not measured against TECO Energy
13 total shareholder return but are used solely as a
14 retention tool. The eligible employee must be employed
15 at the end of a three-year vesting period in order to
16 receive payment of these shares.

17

18 **Q.** On page 16, lines 3 through 9 of his direct testimony,
19 Mr. Pollock proposes that the cost associated with
20 performance and time-vested restricted stock be removed
21 from cost of service. Do you agree?

22

23 **A.** No I do not. The long-term incentive program is part of
24 Tampa Electric's total compensation package and it
25 specifically allows the company to retain some of its key

1 talent. Accordingly, the associated costs are
2 appropriately included in its cost of service.

3
4 **Q.** Mr. Schultz asserts that effective April 2007, the fixed
5 company match for the 401(k) plan was increased from 30
6 to 50 cents and it is not appropriate for the company to
7 increase the contribution to its employees' second
8 retirement plan. Do you agree?

9
10 **A.** No, I do not agree. In April 2007, Tampa Electric did
11 change the company fixed match from 30 cents to 50 cents
12 to be more comparable to other utilities. Based on
13 Towers Perrin's 2007 Energy Services BENCAL study, the
14 employer contribution aspect of TECO Energy's 401(k) plan
15 ranked fourth from the bottom and significantly below the
16 industry average. The study also illustrates that the
17 majority of companies in the "Energy Services" category
18 have a defined benefit plan along with a defined
19 contribution plan. Among companies providing both a
20 defined benefit plan and a defined contribution plan,
21 TECO Energy is still next to last among "Energy Services"
22 companies. These results are shown in Documents No. 1
23 and 2 in my rebuttal exhibit.

24
25 **Q.** On page 16, lines 3 through 7 of his direct testimony,

1 Mr. Schultz criticizes the studies used to justify the
2 company's level of employee benefits. He claims they
3 reflect a limited sample of companies. Do you agree and
4 is it relevant that the surveys do not reflect the small
5 companies that offer limited health care and/or
6 retirement plans or do not offer any health care or
7 retirement plans?

8
9 **A.** I do not agree and Mr. Schultz is incorrect. The BENVAl
10 Study is used by a wide range of peer companies to
11 benchmark benefits. Forty-nine energy services companies
12 participated in the 2007 Energy Services BENVAl Study.
13 Of those 49 companies, 16 were benchmarked against TECO
14 Energy, Inc. These 16 companies were selected for
15 comparison based on similar revenue ranges. To benchmark
16 the company against small companies that are not in the
17 utility industry and without comparative benefits would
18 not provide meaningful information to determine the
19 reasonableness and competitiveness of overall benefits.

20
21 **Q.** Do you agree that a 40 percent downward adjustment for
22 401(k) expense should be made to adjust for a "special
23 add on"?

24
25 **A.** No. The company's change in its fixed match contribution

1 from 30 to 50 cents is not a "special add on". It was an
2 adjustment to get its plan closer to industry market
3 value. His recommended disallowance is totally improper.
4

5 **Q.** On page 18 of his direct testimony, Mr. Schultz claims
6 that employee medical costs may not reflect a proper
7 level of employee contributions. Do you agree?
8

9 **A.** No. Document No. 8 of Exhibit No. __ (DSM-1) in my direct
10 testimony illustrates that Tampa Electric's average
11 medical cost per employee in 2007 was \$6,377 compared to
12 the national average of \$7,983. The company attributes
13 this favorable result to successful cost control
14 strategies including designing employee contribution
15 amounts that encourage cost-effective plan selections
16 through annual adjustments and indexing of deductibles,
17 co-payments and out-of-pocket amounts. The company's
18 level of expense for employee healthcare is reasonable
19 and prudent.
20

21 **Q.** Please summarize your rebuttal testimony.
22

23 **A.** The criticisms raised by the intervenors regarding Tampa
24 Electric's compensation and benefits are without merit
25 and none of their proposed adjustments are warranted.

1 Total compensation, which includes short and long-term
2 incentive plans, is designed to be competitive so that
3 the company can attract and retain the most qualified
4 individuals. Incentive compensation includes customer-
5 focused operational and financial goals. The company's
6 total compensation plan and benefits are set at a level
7 that is comparable with the market. The associated
8 expenses are reasonable, prudent and appropriately
9 reflected in the 2009 test year budget.

10

11 **Q.** Does this conclude your rebuttal testimony?

12

13 **A.** Yes, it does.

14

15

16

17

18

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TAMPA ELECTRIC COMPANY
DOCKET NO. 080317-EI
WITNESS: MERRILL
REBUTTAL EXHIBIT NO. __ (DSM-2)

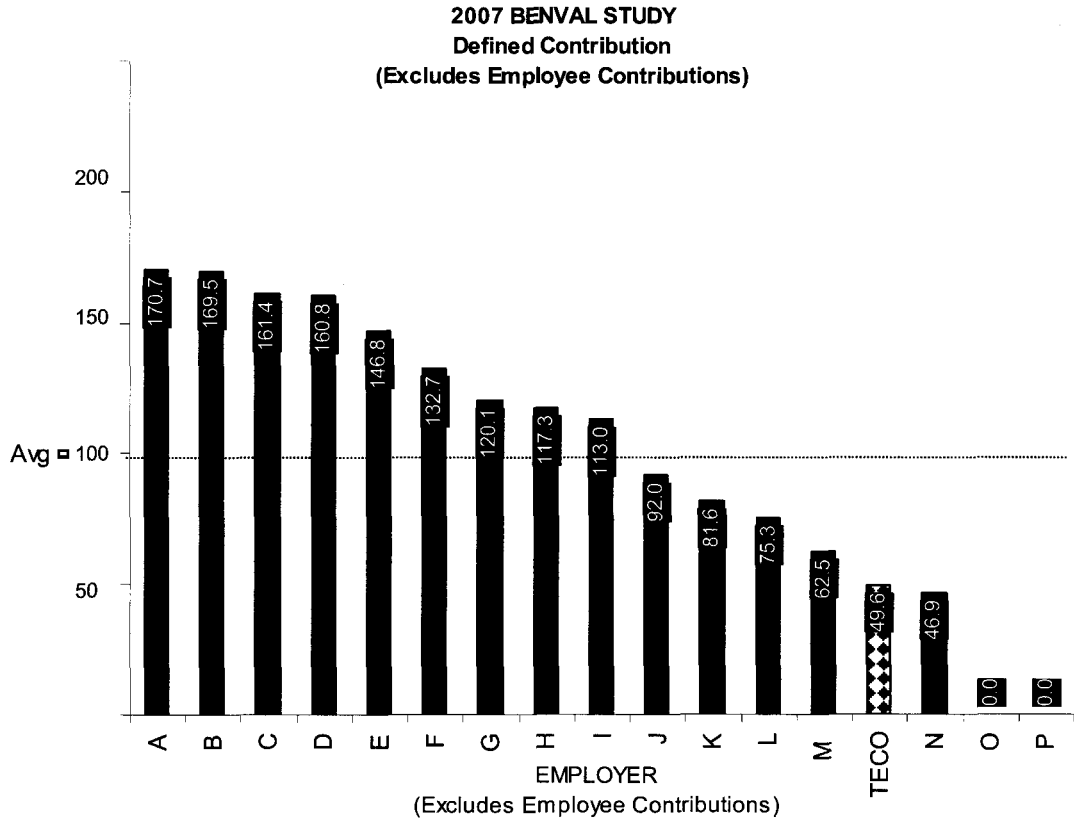
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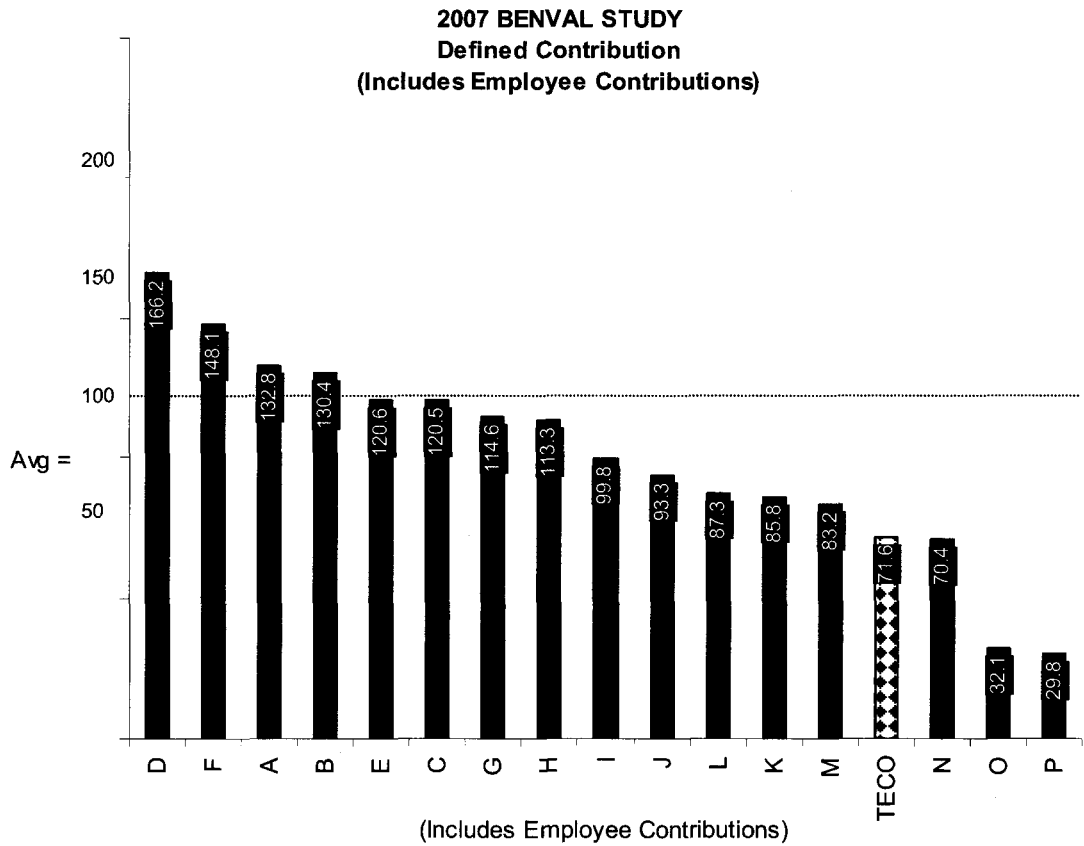
DIANNE S. MERRILL

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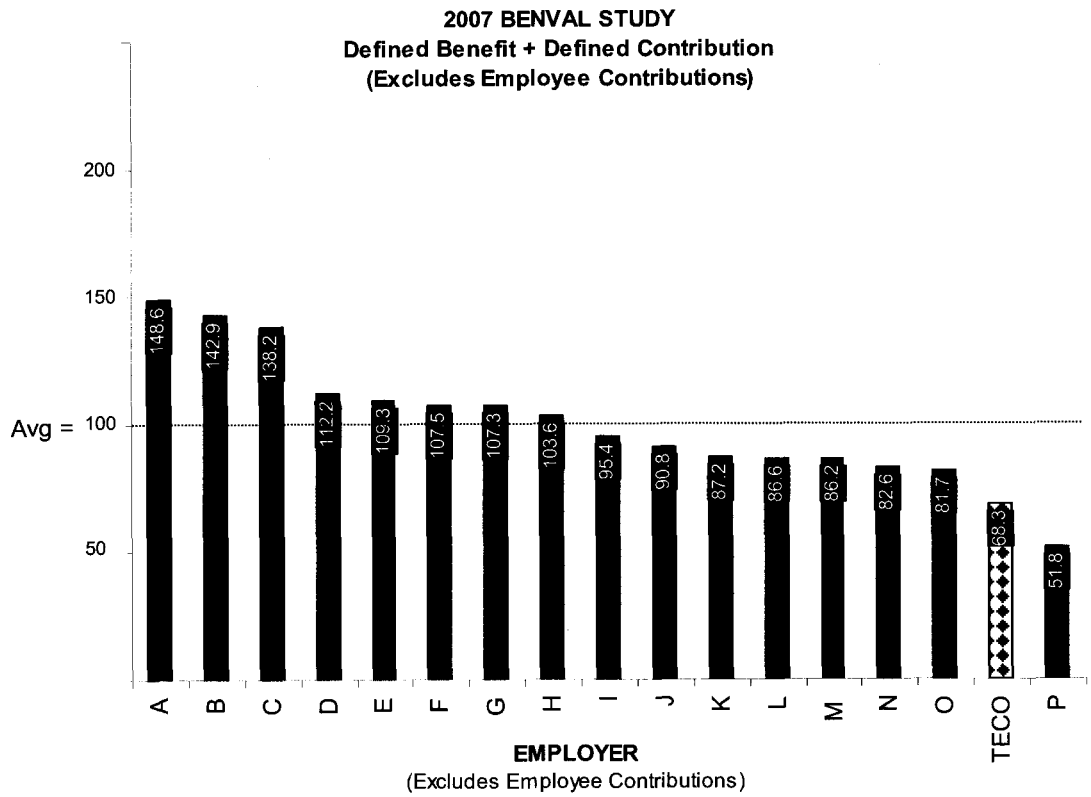
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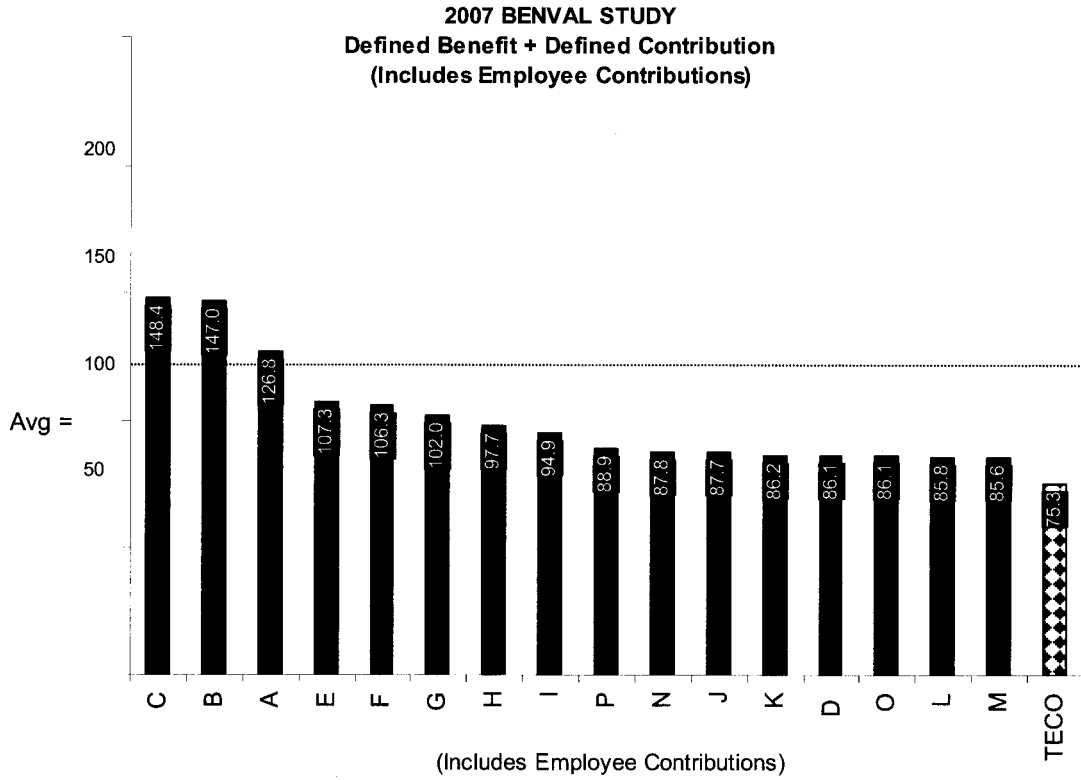
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