BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 110138-EI

REBUTTAL TESTIMONY AND EXHIBIT

OF

DAVID J. WATHEN

GULF POWER

A SOUTHERN COMPANY

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony and Exhibit of
David J. Wathen
Docket No. 110138-EI
In Support of Rate Relief
Date of Filing: November 4, 2011

Q. Please state your name and your business address.

A. My name is David J. Wathen. My business address is 3500 Lenox Road, Suite 900, Atlanta, GA 30326.

Q. By whom are you employed?

A. I have been employed by Towers Watson since 1996 and my position is Director, Atlanta Executive Compensation Practice Leader. Towers Watson is a leading global professional services company, which has 14,000 associates throughout the world, who offer solutions in the areas of employee benefits, talent management, rewards, and risk and capital management.

Q. Please explain the business of Towers Watson in providing compensation services.

A. Towers Watson advises organizations throughout the globe on all aspects of their compensation programs with the goal of paying people appropriately and enabling organizations to attract, retain, motivate, and engage employees efficiently and cost-effectively. Typical areas of consulting assistance include pay philosophy development, variable or at-risk compensation plan design, total compensation benchmarking, and compensation structure development.

Q. Why do companies such as Southern Company and Gulf Power Company retain firms such as Towers Watson for compensation services?

A. Companies retain the services of compensation consultants like Towers Watson because they need access to the expertise and resources that consulting firms have to offer regarding current and emerging market practice, program design and market competitiveness. Towers Watson has extensive experience serving clients in the energy services industry, having served more than 100 energy services industry organizations last year. Because we invest heavily in our energy services industry capabilities, we have rich competitive industry information that enables Southern Company and Gulf to benchmark against similar companies in the U.S. Given Towers Watson's breadth and depth of resources, we are frequently engaged by companies to conduct competitive assessments of total rewards programs including compensation levels by position, at-risk compensation plan design, pay structures and other consulting services.

Q. What are your responsibilities as the Director, Atlanta Executive Compensation Practice Leader at Towers Watson?

A. I manage Towers Watson's executive compensation consulting practice in Atlanta, which includes 12 professional and administrative staff. My key areas of responsibility include:

- Managing, supporting and executing major executive compensation projects and business development initiatives to retain current clients, expand existing relationships and increase market share, projects entail assisting senior management and/or Boards of Directors in managing all aspects of their compensation programs;
- Contributing to the development of plans and budgets, delivering planned performance and ensuring the Executive Compensation practice achieves defined goals;
- Integrating and building team resources into an effective client service delivery team, developing and executing strategic staffing plans and attracting and maintaining engagement and retention of key talent; and
- Overseeing all aspects of local delivery of Towers Watson products and services for the Atlanta Executive Compensation practice and collaborating with other lines of business to develop local market strategies to deepen, broaden and build profitable relationships.

In addition to my leadership and consulting responsibilities, I have been a guest speaker on executive compensation to professional and academic organizations including the Atlanta Area Compensation Association, Emory University, National Association of Stock Plan Professionals, Society of Corporate Secretaries and Governance Professionals and Vanderbilt University.

Q. Please state your prior work experience and responsibilities.

A. Before joining Towers Watson, I was employed as a Project Manager/Systems Support Specialist by Schlumberger Industries from 1990 to 1994, where I trained and supported utilities in the use of computerized meter reading systems. I joined Towers Perrin (predecessor to Towers Watson; Towers Watson reflects the merger of Towers Perrin and Watson Wyatt) in 1996 as a project manager in the compensation practice and was elected a Principal of the firm in 2007. Over my tenure with the firm I have worked with clients in numerous industries (i.e., consumer products, financial services, energy services, high tech, manufacturing, real estate and transportation) and before assuming my current role, I have taken on ever increasing roles and responsibilities, such as:

- Project manager: manage the day-to-day activities of multiple client projects covering competitive benchmarking studies, at-risk compensation plan review and design, proxy analysis, market trends review, etc.;
- People manager: responsible for providing appropriate training and career growth opportunities for associates and conducting performance management and pay planning;
- Consultant: manage multiple small to mid-size client relationships and/or projects, responsible for development and delivery of client studies;

- Senior consultant: manage multiple large, complex client relationships and/or projects, oversee project managers, responsible for development and delivery of client studies.

Q. Please share your educational background.

A. I graduated from Vanderbilt University in 1990 with a B.A. in Economics and earned an M.B.A. with an emphasis in Human Resources from The Owen Graduate School of Management at Vanderbilt University in 1996.

Q. Gulf Power has offered you as an expert witness on corporate public utility compensation programs. What qualifications do you have to testify as an expert on corporate and public utility compensation programs?

A. In my 15 year career with Towers Watson, I have assisted management and Boards of Directors at numerous companies in designing and assessing all aspects of their compensation programs. Since joining the firm in 1996, I have consulted with numerous utilities and currently serve as the leader of the firm's utility industry compensation practice. I have conducted competitive assessments of total compensation levels and at-risk compensation plans for numerous public utilities and currently provide compensation consulting services to several utility clients located across the U.S.

Q. What is the purpose of your rebuttal testimony?

A. I and two other witnesses, Stacy Kilcoyne and Terry Deason, rebut the testimony of Office of Public Counsel (OPC) witness Donna Ramas in which she proposes adjustments to Gulf's projected 2012 test year budget for variable or at-risk compensation.

Q. What exhibits are you sponsoring?

A. I am sponsoring Exhibit DJW-1, consisting of the following three schedules:

- Schedule 1, Historical Market Base Salary Merit Increases for Gulf Power Employees Compared to Utility and General Industry Practices
- Schedule 2, Competitive Market Assessment by Gulf Power Job Level
- Schedule 3, Competitive Market Assessment by Gulf Power Job Level with At-Risk Compensation Component Excluded

Q. What was Towers Watson asked by Gulf Power to do?

A. Towers Watson was asked to assess the competitiveness of Gulf's current total compensation philosophy and programs and present its assessment in response to Ms. Ramas.

Q. What was the purpose of that analysis?

A. The purpose of the analysis was to review the competitiveness of Gulf's current compensation programs relative to market practices, specifically focusing on the following aspects of Gulf's program:

- Total compensation philosophy,
- Annual merit increases,
- Compensation benchmarking process,

- Competitive market positioning of total pay (base salary and at-risk compensation) and
- At-risk compensation programs design.

Q. Have Towers Watson and you performed similar analyses in the past?

A. Yes. Towers Watson and I have conducted similar competitive compensation studies for other utility clients.

Q. What are the conclusions of your analysis?

A. Overall, our analysis indicates that Gulf's total compensation programs are comparable to and competitive with market practices of other similarly sized utilities. Gulf, like all the companies it competes with for talent, has to provide a competitive total compensation opportunity delivered via programs that benefit employees, customers and shareholders. Gulf achieves this goal with its balanced and competitive base salary and at-risk compensation programs. My experience working with both utilities and general industry companies indicates the programs at Gulf fall well within market norms and are not excessive in design or level of pay. The compensation programs covered in our competitive review are summarized below.

Compensation Philosophy

Gulf's compensation philosophy targets base salary and at-risk compensation at the 50th percentile of similarly sized utilities. Towers Watson examined the proxy disclosures for 19 publicly-traded utilities comparable in size to Southern Company (revenues ranged from ½ to 2-times Southern Company revenues of $17.5 billion) and 13 publicly-traded utilities comparable in size to Gulf (revenues ranged from ½ to 2-times Gulf revenues of $1.6 billion). When developing a competitive benchmarking peer group, the competitive range of ½ to 2-times revenues is a standard practice in our business and is also utilized by Institutional Shareholder Services (ISS), a noted proxy advisory firm. Based on our review, Gulf's total compensation philosophy aligns well with peer practices as a majority of the utility peers (16 of 19 utilities comparable in size to Southern Company and 12 of 13 utilities comparable in size to Gulf) target the market 50th percentile for some or all pay elements. Our consulting experience also suggests that Gulf's 50th percentile pay philosophy is comparable to typical market practice found in general industry.

<u>Annual Merit Increases</u>

Based on a review of average base salary merit increases provided to all eligible employees at Gulf from 2001 to 2011 and competitive market data from WorldatWork Salary Budget Surveys from 2004 to 2011, historical average merit increases provided to all employees at the Company have typically been below market levels for 9 of the last 11 years compared to utilities and 8 of the last 11 years compared to general industry. It is important to note that given the severe economic decline experienced in 2009, Gulf did not provide merit increases to any employee or a general increase to its bargaining unit employees. Details of this analysis are included in Schedule 1 of Exhibit DJW-1.

Compensation Benchmarking Process

Towers Watson also reviewed Gulf's process for determining market competitive compensation levels for each employee group (management, professional employees, non-exempt employees and employees covered under a collective bargaining agreement). We found the process used by Gulf to be consistent with utility and general industry market best practices.

Compensation Competitive Market Positioning

After reviewing Gulf's benchmarking process, we then assessed the competitiveness of compensation levels based on Gulf's stated total compensation philosophy. To conduct this analysis we reviewed data provided to us by Gulf and examined Towers Watson's 2010 Energy Services Compensation surveys. These surveys are comprised of compensation data from over 100 U.S.-based energy services companies. Towers Watson has been conducting these surveys for over 20 years.

We determined that Gulf's compensation by job level aligns with the Company's total compensation philosophy of targeting base salary, target total cash compensation (target TCC = base salary + target short term at-risk compensation) and target total direct compensation (target TDC = target TCC + long-term at-risk compensation) at the 50^{th} percentile of the market for comparable positions. See Schedule 2 of Exhibit DJW-1 for details of this analysis.

At-Risk Compensation Programs

Towers Watson next assessed the design of Gulf's at-risk compensation plans: Performance Pay Program and long-term at-risk compensation programs.

In assessing the competitiveness of the Performance Pay Program, we examined market data from the following market perspectives: proxy disclosures for 19 publicly-traded utilities comparable in size to Southern Company (revenues ranged from ½ to 2-times Southern Company revenues of $17.5 billion), 13 publicly-traded utilities comparable in size to Gulf (revenues ranged from ½ to 2-times Gulf revenues of $1.6 billion) and 15 energy services industry companies in Towers Watson's Annual Incentive Plan Design survey. Our review suggests that Gulf's Performance Pay Program design is comparable to and competitive with short-term at-risk compensation plan designs of the market perspectives examined. Also, it is important to note that Gulf puts equal weighting on all performance measures for all program participants (1/3 weight on corporate EPS, 1/3 weight on business unit ROE and 1/3 weight on operational goals) to emphasize the equal importance of all performance measures and ensure employees have a vested interest in achieving all goals.

The competitive review of Gulf's long-term at-risk compensation program examined proxy disclosures for the same proxy peers noted earlier in my testimony and data from Towers Watson's 2010 Energy Services Long-Term Incentive Plan Report, which presents plan design data for 95 energy services industry participants. Based on our review, we found the Company's long-term at-risk compensation program design, reflecting annual grants of stock options and performance shares to be competitive with the market perspectives examined. Gulf's program differed from market practice in the following areas:

- Vehicle Mix – Gulf's use of stock options and performance shares reflects a stronger performance focus than most utility peers. For those peers that use two long-term incentive vehicles, performance shares and time-vested restricted stock are the most commonly used vehicles,
- Award Eligibility – Gulf grants long-term at-risk compensation at lower levels in the organization than typical market practice. Broader award eligibility at Gulf is intended to ensure more employees have a long-term performance focus.
- Maximum Performance Level – Gulf requires higher relative total shareholder return (TSR) performance to deliver a maximum performance share award than typical peer practice (90^{th} percentile Company relative TSR performance versus 75^{th} percentile relative TSR performance for peers),
- Relative Peer Groups – Gulf uses two relative performance peer groups in determining performance share awards. The peer groups

are the Philadelphia Utility Index and a 9 company custom peer group. Typical utility practice entails the use of a single relative peer group or index.

As part of Southern Company's ongoing review of market best practices, Gulf discontinued awards under the Performance Dividend Program in 2010. This program was no longer competitive with utility peer market practice and the last possible payment of awards will be in March 2013.

In summary, we find the form, mix and levels of total compensation at Gulf to be consistent with the Company's stated total compensation philosophy and competitive with market practices of similarly sized utilities. It is through these market-competitive compensation programs that Gulf is able to attract and retain employees with the knowledge and skills needed for continued success.

Q. How does your analysis relate to Ms. Ramas' compensation testimony?

A. Ms. Ramas recommends disallowance of all at-risk compensation at Gulf; however, our analysis concludes that Gulf needs to maintain the market competitive at-risk compensation plans. The elimination of at-risk compensation, without any sort of replacement compensation, would result in total compensation at Gulf that is below market competitive levels and it will adversely impact the Company's ability to attract and retain employees. See Schedule 3 of Exhibit DJW-1 for details of this analysis.

Also, it is important to note that there is the possibility of unintended consequences with the elimination of all at-risk compensation at Gulf. In order to remain competitive, Gulf could be forced to increase fixed pay (i.e., base salary) to non-competitive levels in order to attract and retain talent, which would be financially irresponsible from a pay-for-performance perspective.

In an environment where utilities have aging workforces and the need to replace critical skills will only grow as employees retire, it is essential for Gulf to be able to attract and retain qualified employees. As noted in Towers Watson's competitive assessment, Gulf's at-risk compensation programs are market competitive. Gulf invests considerable time and thought in the design of its at-risk compensation plans to insure they are not only providing a competitive total compensation opportunity but doing so in a manner that best serves the interests of both customers and shareholders.

Q. Why do you not address Ms. Ramas' complement or head count adjustment?

A. Essentially because I am not qualified to address it. Whether workforce is necessary or essential is best left to the company to determine.

Q. Does this conclude your testimony?

A. Yes.

AFFIDAVIT

STATE OF GEORGIA)
)
COUNTY OF FULTON)

Docket No. 110138-EI

Before me the undersigned authority, personally appeared David J. Wathen, who being first duly sworn, deposes, and says that he is Director, Atlanta Executive Compensation Practice Leader, of Towers Watson, and that the foregoing Rebuttal Testimony in Support of Rate Relief, to be filed on or about November 4, 2011 before the Florida Public Service Commission, is true and correct to the best of his knowledge, information, and belief.

The signed original affidavit is attached to the original testimony on file with the FPSC.

/s______________________________
David J. Wathen

Sworn to and subscribed before me this ______ day of __________________, 2011.

____Personally Known
____Produced Identification
Type and # of ID_______________

____
Notary Public, State of Georgia at Large

Commission No. ______________________
My Commission Expires ________________

Florida Public Service Commission
Docket No. 110138-EI
GULF POWER COMPANY
Witness: David J. Wathen
Exhibit No. ______(DJW-1)
Schedule 1
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Historical Market Base Salary Merit Increases for Gulf Power Employees

Compared to Utility and General Industry Practices

Year	Gulf Power Average Increase as % of salary	Utility Median Actual Salary Budget Increase	General Industry Median Actual Salary Budget Increase
2011	2.7%	3.0%	3.0%
2010	2.7%	2.8%	2.7%
2009	0.0%	3.0%	2.5%
2008	3.7%	4.1%	3.9%
2007	3.5%	3.7%	3.9%
2006	3.6%	3.8%	3.8%
2005	3.4%	3.6%	3.7%
2004	3.1%	3.4%	3.6%
2003	4.0%	3.3%	3.6%
2002	4.2%	3.8%	3.9%
2001	4.2%	4.4%	4.6%

Source: Gulf Power and WorldatWork Salary Budget Surveys, 2004 – 2011

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Schedule 2
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Competitive Market Assessment by Gulf Power Job Level

Job level	Salary Variance to Market 50th Percentile***	Target TCC* Variance to Market 50th Percentile***	Target TDC** Variance to Market 50th Percentile***
Bargaining Unit Employees	-8.4%	-7.5%	-7.5%
Non-Exempt Employees	-0.6%	3.1%	3.1%
Professional Employees	-3.5%	-3.5%	-3.5%
Management	0.4%	5.0%	2.8%
Gulf Power Overall	-4.6%	-2.9%	-3.2%

* Target TCC = base salary + target short-term at-risk compensation
** Target TDC = target TCC + long-term at-risk compensation
***Variance to Market 50th Percentile represents the difference between Gulf Power pay and market 50th percentile pay (e.g., Gulf Power pay / Market 50th percentile pay – 1)

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Competitive Market Assessment by Gulf Power Job Level with At-Risk Compensation Component Excluded

Job level	Salary Variance to Market 50th Percentile***	Target TCC* Variance to Market 50th Percentile***	Target TDC** Variance to Market 50th Percentile***
Bargaining Unit Employees	-8.4%	-12.0%	-12.0%
Non-Exempt Employees	-0.6%	-6.2%	-6.2%
Professional Employees	-3.5%	-13.2%	-13.2%
Management	0.4%	-19.2%	-27.6%
Gulf Power Overall	-4.6%	-13.3%	-15.2%

* Target TCC = base salary + target short-term at-risk compensation
** Target TDC = target TCC + long-term at-risk compensation
***Variance to Market 50th Percentile represents the difference between Gulf Power pay and market 50th percentile pay (e.g., Gulf Power pay / Market 50th percentile pay – 1)