

Volume 2B

Direct Testimony and Supporting Schedules:

Peter E. Wasberg

Before the South Dakota Public Utilities Commission
State of South Dakota

In the Matter of the Application of Otter Tail Power Company
For Authority to Increase Rates for Electric Utility
Service in South Dakota

Docket No. EL18-___

Exhibit ___

EMPLOYEE COMPENSATION

Direct Testimony and Schedules of

PETER E. WASBERG

April 20, 2018

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1 **I. INTRODUCTION AND QUALIFICATIONS**

2 Q. PLEASE STATE YOUR NAME AND OCCUPATION.

3 A. My name is Peter E. Wasberg. I am employed by Otter Tail Power Company (Company
4 or OTP) as Director, Human Resources and Safety.

5
6 Q. PLEASE SUMMARIZE YOUR QUALIFICATIONS AND EXPERIENCE.

7 A. I graduated from Concordia College, Moorhead, MN with degrees in business
8 administration and psychology and have worked at OTP since 1991. Prior to moving into
9 the Human Resources Department in 2004, I primarily worked within the customer
10 service/operations area of OTP. I have been in my current role since January 2008. A
11 copy of my resume is included as Exhibit___(PEW-1), Schedule 1.

12 **II. PURPOSE AND OVERVIEW OF DIRECT TESTIMONY**

13 Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?

14 A. My Direct Testimony describes matters related to employee compensation and benefits
15 for OTP.

16
17 Q. PLEASE PROVIDE A BRIEF OVERVIEW OF YOUR DIRECT TESTIMONY.

18 A. First, I will briefly describe OTP's current compensation plan, including its two annual
19 incentive plans (collectively the "OTP Annual Incentive Plan"). Second, I will discuss
20 how the compensation levels provided by OTP compare to the general market. Third, I
21 will generally describe the benefits provided by OTP. Fourth, I will summarize OTP's
22 2017 compensation and benefits costs.

23
24 Q. HOW IS YOUR DIRECT TESTIMONY ORGANIZED?

25 A. In Section III, I describe OTP's workforce and compensation plan. In Section IV, I
26 discuss OTP compensation levels and the competitive market. In Section V, I provide a
27 description of OTP's employee benefits. In Section VI, I describe OTP's 2017 employee
28 compensation costs, and in Section VII, I provide my conclusion.

1 **III. OVERVIEW OF OTP'S WORKFORCE AND COMPENSATION**
2 **PLAN**

3 Q. PLEASE BRIEFLY DESCRIBE OTP'S WORK FORCE.

4 A. In 2017, OTP had an average of 776 full-time equivalent employees, including
5 approximately 390 union employees and 386 non-union employees (these numbers are
6 not adjusted for employees of jointly-owned plants). The non-union full-time equivalent
7 employees include: (1) the OTP President and 8 other executives; (2) 259 exempt
8 employees; and (3) 118 non-exempt employees. OTP employees provide a wide range of
9 services required to provide electric utility services to our approximately 132,100
10 customers located in South Dakota, Minnesota, and North Dakota. OTP's workforce
11 supports a substantially larger net plant in service than it did in 2009. OTP witness Mr.
12 Bruce Gerhardson discusses the magnitude of infrastructure additions.

13
14 Q. WHAT ARE OTP'S COMPENSATION GOALS FOR ITS WORKFORCE?

15 A. OTP's compensation goals are to attract, retain and engage employees. OTP's employees
16 are essential to achieve OTP's mission, which is to produce and deliver electricity as
17 reliably, economically and environmentally responsibly as possible to the balanced
18 benefit of customers, shareholders, and employees, and to improve the quality of life in
19 the areas in which we do business. OTP focuses on maintaining a compensation program
20 that provides a competitive, performance-based pay system that helps us attract and retain
21 a quality workforce that provides our customers with safe, reliable, and economical
22 service.

23
24 Q. IS OTP FACING CHANGES THAT INCREASE THE IMPORTANCE OF THESE
25 GOALS?

26 A. Yes. We expect to have over 35 percent (over 275) of our employees retire during the
27 next ten years. We also have the potential for another 150 - 200 employees to leave
28 employment during this same ten-year period based on historic non-retirement attrition.
29 Based on exit interviews conducted with approximately 50 percent of the employees who
30 have left OTP for reasons other than retirement since 2011, we find that some of these

1 non-retirement attritions go to other utilities. The reasons cited vary and include
2 increased compensation and/or benefits, a desire for a different geographic setting, and in
3 some cases career advancement. As a relatively small utility serving the rural areas of
4 North Dakota, Minnesota and South Dakota, OTP faces challenges in attracting and
5 retaining skilled workers, especially mobile workers who are in the earlier stages of their
6 careers.

7
8 Q. WHAT ARE THE MAIN COMPONENTS OF OTP'S COMPENSATION PLAN?

9 A. The OTP compensation plan consists of: (1) a combination of base salaries or base
10 wages, plus annual incentive compensation for non-union employees; (2) standard
11 employee benefit plans, including health and dental plans, a 401(k) retirement savings
12 plan with an employer match, and an employee stock ownership plan; (3) defined benefit
13 pensions and post-retirement health benefits for employees whose employment began
14 before OTP closed participation in these plans in 2006 (as I describe later in my Direct
15 Testimony); and (4) defined contributions to a 401(k) plan for other employees. Some
16 key OTP management employees are also eligible for long-term incentives. I discuss the
17 cash compensation for OTP employees in this Section III of my Direct Testimony and I
18 will discuss benefits for OTP employees in Section V of my Direct Testimony.

19
20 Q. PLEASE BRIEFLY DESCRIBE THE BASE SALARY AND WAGE COMPONENT
21 OF OTP'S COMPENSATION PLAN.

22 A. OTP has a combination of hourly and salaried employees. Approximately 50 percent of
23 OTP's employees are represented by unions and 16 percent are non-union employees
24 who receive hourly compensation. OTP has approximately 32 percent salaried (or
25 exempt) employees who are not part of management. All employees receive either a base
26 wage or base salary as part of the employee's cash compensation.

27
28 Q. PLEASE BRIEFLY DESCRIBE THE OTP ANNUAL INCENTIVE PLAN.

29 A. The OTP Annual Incentive Plan is provided to all regular employees who are not
30 represented by a union and who work at the rate of at least 1,000 hours per year. The

1 OTP Annual Incentive Plan consists of two separate plans for: (1) non-union employees
2 (the “OTP Key Performance Award Plan” or “OTP KPA Plan”); and (2) key
3 management employees (the “OTP Management Plan”).
4

5 Q. PLEASE BRIEFLY DESCRIBE THE OTP KPA PLAN.

6 A. The OTP KPA Plan covers approximately 377 OTP non-union employees. The
7 maximum payout level under the OTP KPA Plan is 6 percent an individual’s employee’s
8 base salary. The OTP KPA Plan is based on: (1) three operating criteria (safety,
9 customer satisfaction, and equivalent plant availability); and (2) one financial criterion
10 relating to the control of operation and maintenance (O&M) costs. Each of these four
11 criteria has a weighting that together comprise the 6 percent maximum payout.
12

13 Q. PLEASE EXPLAIN THE WEIGHTING OF THE FOUR INDIVIDUAL CRITERIA.

14 A. Of the 6 percent maximum payout: (1), customer satisfaction has a total weighting of 2
15 percent, and in 2018 we will utilize two separate targets, each worth 1 percent; (2)
16 equivalent plant availability has a weighting of 1 percent; (3) safety has two targets, each
17 worth 0.5 percent; and (4) the O&M cost control criteria has a weighting of 2 percent.
18 Payouts under the three operating criteria are not financially tied to the O&M cost control
19 criterion.
20

21 Q. IS OTP PROPOSING A LIMIT ON THE LEVEL OF COST RECOVERY FOR THE
22 KPA PLAN?

23 A. Yes. OTP is proposing to limit the recovery of incentive compensation under the KPA
24 Plan to the average payout level over the past five years, which is approximately 3.5
25 percent, as I will explain in more detail later in my Direct Testimony.
26

27 Q. PLEASE BRIEFLY DESCRIBE THE OTP MANAGEMENT PLAN.

28 A. The OTP Management Plan covers 19 OTP management employees (not including the
29 OTP President who has a separate plan). The OTP Management Plan includes: (1)
30 safety; (2) a number of individual criteria that vary by the employee’s job and

1 responsibilities; and (3) two overall financial criteria relating to OTP. The safety and
2 individual criteria have a cumulative weighting of 50 percent. The financial criteria have
3 a weighting of 50 percent.
4

5 Q. IS OTP PROPOSING A LIMIT ON THE LEVEL OF COST RECOVERY FOR THE
6 OTP MANAGEMENT PLAN?

7 A. Yes. The settlement in OTP's last general rate case in Docket EL10-011 included a
8 limitation on recovery of costs of the OTP Management Plan based on 25 percent of base
9 salary. Consistent with that approach, OTP is proposing to limit the recovery of costs of
10 the Management Plan in this case capped at 25 percent of an individual's base salary.
11

12 Q. PLEASE DESCRIBE THE INCENTIVE PLAN FOR THE OTP PRESIDENT.

13 A. The OTP President is under the Otter Tail Corporation Executive Annual Incentive Plan.
14 Under that plan, the criteria and target incentives are determined by the Compensation
15 Committee of the Otter Tail Corporation Board of Directors. Criteria under the current
16 plan include: (1) OTP net income; (2) OTP return on equity; (3) Otter Tail Corporation
17 earnings per share; (4) individual performance; and (5) OTP OSHA safety case rate.
18

19 Q. IS OTP PROPOSING A LIMIT ON THE LEVEL OF COST RECOVERY FOR THE
20 OTP PRESIDENT'S INCENTIVE PLAN?

21 A. Yes. The OTP President's target incentive is 50 percent of base pay, but OTP is also
22 proposing to limit the level of incentive compensation recovered in rates to 25 percent of
23 the OTP President's individual base salary. Again, this is consistent with the treatment in
24 OTP's last South Dakota general rate case.
25

26 Q. DO THE FINANCIAL CRITERIA OF OTP'S ANNUAL INCENTIVE PLANS
27 PROVIDE BENEFITS TO CUSTOMERS?

28 A. Yes. The financial performance components of the OTP Annual Incentive Plan benefit
29 customers because financial performance depends on the prudent management of costs,
30 which allows electric utility service to be provided at reasonable prices. Combining

1 financial criteria, along with performance measures, ensures that we maintain the balance
2 between reliable service and reasonable prices. We believe in this balance and that the
3 financial criteria provide a benefit to our customers.
4

5 Q. HOW DOES THE OTP ANNUAL INCENTIVE PLAN FIT INTO OTP'S TOTAL
6 COMPENSATION PLAN AND COMPENSATION GOALS?

7 A. The OTP Annual Incentive Plan is an important part of our total compensation plan.
8 Without our annual incentive plan, OTP's total cash compensation would be significantly
9 below the market median of total cash compensation, and OTP would be impeded in its
10 ability to attract and retain essential employees. The annual cash incentive compensation
11 that is part of the OTP Annual Incentive Plan also encourages increased productivity and
12 enables OTP to reward employees for providing quality service to our customers. Both
13 customers and employees benefit from setting incentives that tie directly to our
14 customers' needs.

15 The OTP Annual Incentive Plan also helps us to maintain workforce continuity.
16 Reliability of our electrical plants and electrical systems is enhanced when we have
17 continuity in our workforce. The technical knowledge needed, and the years that it
18 actually takes to acquire the specialized skills for our system, are paramount to our ability
19 to reliably and efficiently provide energy to our customers. Our customers also see the
20 advantages of reduced costs associated with the lower recruitment and training
21 requirements associated with a stable workforce. With an expected retirement rate of
22 approximately 35 percent in the next ten years, we see maintaining a competitive
23 compensation package as a critical requirement for our customers and company.
24

25 Q. WHAT IS THE ALTERNATIVE TO THE USE OF ANNUAL INCENTIVE
26 COMPENSATION IN OTP'S COMPENSATION PACKAGE?

27 A. Without annual incentive compensation, the only way to maintain a competitive cash
28 compensation package would be to increase base salaries, which would increase other
29 costs and substantially reduce both flexibility and incentives for performance.
30

1 Q. DOES OTP PROVIDE LONG TERM INCENTIVES?

2 A. Yes. Qualifying management employees may receive long-term incentives in the form of
3 grants of restricted stock units. In 2017, 20 OTP employees (including the OTP
4 President) received grants of restricted stock. Qualifying employees are awarded
5 restricted stock units based on salary, job level, and the price of the stock at the date of
6 grant. These long-term incentives are considered along with other components of
7 compensation when we review compensation levels. The purposes of OTP's long-term
8 incentives are to: (1) link the long-term success of OTP to qualifying employee
9 compensation; (2) encourage the retention of management over the long-term; and (3)
10 provide the opportunity to earn competitive total compensation. OTP has included the
11 costs of long-term incentives for OTP employees in the 2017 Test Year, also subject to a
12 25 percent cap as described above for the Management Incentive Plan.

13 **IV. OTP COMPENSATION LEVELS AND THE COMPETITIVE**
14 **MARKET**

15 Q. DOES OTP USE INFORMATION REGARDING COMPENSATION AT OTHER
16 UTILITIES AND BUSINESSES IN CONNECTION WITH ITS COMPENSATION
17 DECISIONS?

18 A. Yes. OTP routinely compares its compensation levels to those of other utilities and some
19 non-utilities, using a number of surveys and information sources, including Towers
20 Watson (Towers), Mercer, and Aon Hewitt (Hewitt). Every three to four years, OTP
21 participates in a benchmark study for non-executive employees, the most recent of which
22 was conducted by Mercer and completed in 2015. We periodically participate in studies
23 of executive compensation, which I discuss in Section VI of my Direct Testimony. We
24 also routinely review collective bargaining agreements from other utilities.
25

26 Q. PLEASE EXPLAIN HOW OTP USES BENCHMARK STUDIES.

27 A. OTP uses benchmark studies as the framework for formulating its compensation
28 programs. Salary surveys are reviewed and analyzed to find positions that correspond
29 with the essential job duties, skills, and functions of OTP's positions. OTP strives to set

1 compensation at or near the median of the survey data. While the market-based
2 compensation for a position is based on the median, it is not limited to the single data
3 point of the median. Rather, the relevant market for a position includes a range above
4 and below the median. The compensation for OTP non-union employees is ultimately
5 determined by a combination of market data and the employee's responsibilities,
6 performance, and experience.

7
8 Q. PLEASE FURTHER EXPLAIN THE 2015 MERCER BENCHMARK STUDY.

9 A. The 2015 Mercer Benchmark Study covered non-executive employees and included
10 compensation information for a broad sample of positions. The 2015 Mercer Benchmark
11 Study examined base salaries and annual incentives. OTP compensation levels were
12 compared using a combination of general industry, energy/utility industry, and North
13 Central regional data to reflect the labor markets in which OTP competes for employees.
14 A copy of a portion of the 2015 Mercer Compensation Benchmark Study is provided as
15 NOT PUBLIC Exhibit ___(PEW-1), Schedule 2.

16
17 Q. WHAT DID THE 2015 MERCER BENCHMARK STUDY INDICATE FOR NON-
18 EXECUTIVE EMPLOYEES?

19 A. The 2015 Mercer Benchmark Study showed that:

- 20 1. OTP base salaries overall were 6 percent above the base salary medians;
- 21 2. OTP incentive compensation structure was 7 percent below the market median;
- 22 and
- 23 3. OTP total cash compensation levels (base salary plus annual incentive) overall
24 were 1 percent above the market medians.

25 Of the 100 non-union positions that were reviewed, some fell below the market median
26 and some were above the market median.

27
28 Q. WHAT DID YOU CONCLUDE FROM THESE RESULTS?

29 A. Taken together, the 2015 Mercer Benchmark Study confirms that OTP is neither a market
30 leader nor significantly below market in its non-executive compensation levels. The

1 2015 Mercer Benchmark Study showed that, overall, the OTP compensation plan is
2 competitive with the market and reasonable, especially considering the average tenure of
3 our employee group. It also indicated that our compensation structure included in our
4 rate request for non-executive employees is fair and reasonable.
5

6 Q. HAS A RECENT STUDY OF EXECUTIVE COMPENSATION BEEN CONDUCTED?

7 A. Yes. In 2015 Mercer also conducted an Executive Compensation Review for OTP which
8 evaluated a number of compensation components, including: (1) Base Salary; (2) Total
9 Cash Compensation; and (3) Total Direct Compensation (including Base Salary, Annual
10 Incentive Compensation, and Long-Term Incentive). The 2015 Mercer Executive
11 Compensation Review utilized multiple data points including: (1) Mercer 2015 US
12 Executive Remuneration Suite; (2) the Towers Watson 2015 CDB Energy Services
13 Executive Compensation Survey; (3) the Mercer 2015 Total Compensation for the
14 Energy Sector Survey; (4) the Mercer 2015 US Short Term Incentive Survey; and (5) the
15 Mercer 2015 US Long Term Incentive Survey. Mercer utilized survey data from the
16 Energy and Utility industry sectors where possible and applied discounts and premiums
17 when the survey data reflected companies that were significantly larger or smaller than
18 OTP. A copy of the 2015 Mercer Executive Compensation Review is provided as NOT
19 PUBLIC Exhibit ___(PEW-1), Schedule 3.
20

21 Q. WHAT DID THE 2015 MERCER EXECUTIVE COMPENSATION REVIEW SHOW?

22 A. The Study showed the following:

- 23 1. OTP executive Base Salaries were 4 percent below the market median.
- 24 2. OTP's actual executive Total Cash Compensation was 5 percent below the market
25 median.
- 26 3. OTP executive Total Direct Compensation was 12 percent below the market
27 median.
28

1 Q. WHAT DID YOU CONCLUDE FROM THESE RESULTS?

2 A. I concluded that OTP's executive Total Cash Compensation and executive Total Direct
3 Compensation are generally below the market median and that all the components of
4 OTP's executive Total Direct Compensation are reasonable and necessary.

5 **V. EMPLOYEE BENEFITS**

6 Q. PLEASE SUMMARIZE THE BENEFITS PROVIDED BY OTP.

7 A. As I will explain in more detail, OTP provides: (1) employee medical/dental benefits; (2)
8 retirement benefits, including a defined benefit pension plan and a defined contribution
9 401(k) plan; and (3) other post retirement employee benefits.

10

11 Q. ARE THE BENEFITS PROVIDED BY OTP A REASONABLE PART OF EMPLOYEE
12 COMPENSATION?

13 A. Yes. OTP's benefits contribute to attracting and retaining its skilled workforce. As
14 discussed above, OTP and its customers are directly benefited by having a stable, long-
15 term workforce. In an industry where multiple years of training can be required for
16 employees to work independently, it is more fiscally prudent to have a workforce with a
17 low turnover rate. As we retire over 35 percent of our workforce within the next ten
18 years, it will be increasingly important for OTP to attract and retain a workforce that will
19 continue to provide electricity to our customers in a safe, reliable, and efficient manner.

20 **A. Medical and Dental Plans**

21 Q. PLEASE DESCRIBE OTP'S MEDICAL AND DENTAL BENEFITS.

22 A. OTP provides employees with the option to elect group medical and dental insurance
23 benefits. At present, we have three high deductible health plans (HDHP) for our non-
24 union employees and a separate single HDHP option for our union employees. A
25 comparison of the health care plans is provided in Table 1 below. Premiums for the
26 medical and dental plans vary based on the plan(s) chosen, whether dependents are
27 covered, and differences between current non-union and union plans that will be further

described. We continue to work to maintain reasonable costs for OTP while providing quality health care plan options for our employees.

Table 1

2017 Medical Plans				
	Nonunion Employees			Union Employees
	Premier 80	Advantage 70	Basic 100	Blue Saver 100
Annual Deductible	\$1,500 – Employee \$3,000 – Other Tiers	\$3,000 – Employee \$6,000 – Other Tiers	\$6,550 – Employee \$13,100 – Other Tiers	\$2,600 – Employee \$5,000 – Other Tiers
Co-Insurance	80% after deductible	70% after deductible	100% after deductible	NA
Annual Out of Pocket Max	\$3,000 – Employee \$6,000 – Other Tiers	\$6,000 – Employee \$9,000 – Other Tiers*	\$6,550 – Employee \$13,100 – Other Tiers	\$2,600 – Employee \$5,000 – Other Tiers
* While the OOPM is not embedded, ACA rules limit the individual annual liability to \$7,150. This amount is subject to change annually.				

Q. HAS OTP TAKEN STEPS TO CONTROL THE COST OF MEDICAL AND DENTAL BENEFITS?

A. Yes. In 2012, OTP moved to a HDHP for all employees. The move to the HDHP, sometimes called a consumer-driven health plan, has enabled our employees to be better health care consumers. Exhibit___(PEW-1), Schedule 4, details multiple scenarios, comparing our previous health care plan to the HDHP. Moving to the new HDHP resulted in estimated savings of \$5 million to over \$15 million over the 2012-2017 period. In 2017, we took a further step with our non-union employees and replaced the existing HDHP with three new HDHP options that included different deductibles, premiums, and these plan options also introduced coinsurance. Coinsurance keeps employees in the decision-making process longer and that generally provides for increased consumerism. Although health care costs continue to be a challenge for companies, we believe our actions to this point have enabled us to be better consumers, and we expect that our emphasis on preventive health care and wellness will provide long-term benefits for our employees and for Company health care costs.

1 Q. HAS OTP TAKEN OTHER STEPS TO CONTROL THE COST OF MEDICAL AND
2 DENTAL BENEFITS?

3 A. Yes. In 2017, OTP also increased the cost-sharing ratio of employee to employer share of
4 the health care premium. This ratio is now at 15 percent employee/85 percent employer
5 of the total premium cost in the Advantage 80 Plan. Prior to this, the ratio was 4 percent
6 employee/96 percent employer of the total premium cost. The employer share/employee
7 share for gross health costs, which includes total spend for both OTP and employees,
8 moved from approximately 80 percent employer/20 percent employee to 70 percent
9 employer/30 percent employee on all three of the new HDHPs. With these changes for
10 non-union employees in 2017, the Company also added a monthly tobacco surcharge of
11 \$40 and we eliminated health care eligibility for spouses who were able to obtain health
12 care insurance from their own employer. Our union employees, as a result of our 2017
13 negotiations, will contribute more to health care costs as well. Our union employee
14 contributions will increase each year of the three-year contract and the gross health cost
15 ratio will increase to approximately 75 percent employer/25 percent employee in the third
16 year of both contracts. Some of these changes are difficult on our employees and we
17 will continue working on providing quality health care options for our employees while
18 being responsible with the overall costs associated with the benefit.

19 **B. Retirement and Pension Benefits**

20 Q. PLEASE SUMMARIZE OTP'S RETIREMENT SAVINGS AND PENSION BENEFITS

21 A. OTP provides 401(k) defined contribution retirement plans (collectively the "401(k)
22 Plan") for all employees and defined benefit pension plans (collectively the "Pension
23 Plan") for certain employees depending on the date they were hired. OTP also provides a
24 401(k)-matching plan.

25

26 Q. PLEASE DESCRIBE OTP'S 401K PLAN.

27 A. For employees who are not eligible to participate in OTP's Pension Plan, OTP has 401(k)
28 Plans that include three different defined contribution amounts made by OTP: (1) a 4
29 percent contribution for non-union employees; (2) a 7 percent contribution for our Coyote

1 Station union employees; and (3) a 5 percent contribution for our other union employees.
2 A summary description of OTP's 401(k) Plan is included in in Exhibit__(PEW-1),
3 Schedule 5a.
4

5 Q. DOES OTP PROVIDE MATCHING FOR EMPLOYEE CONTRIBUTIONS TO THE
6 401(k) PLAN?

7 A. Yes. For the majority of OTP employees, OTP will match 50 percent of the first 5
8 percent contributed by an employee (2.5 percent maximum). For our Coyote Station
9 union employees, and for our other union employees not eligible to participate in the
10 Pension Plan, OTP will match 50 percent of the first 6 percent contributed by an
11 employee (3 percent maximum).
12

13 Q. ARE EMPLOYEES ELIGIBLE TO PARTICIPATE IN OTP'S PENSION PLAN ALSO
14 ELIGIBLE TO PARTICIPATE IN THE MATCHING PORTION OF OTP'S 401(K)
15 PLAN?

16 A. Yes. Pension-eligible employees may make contributions to OTP's 401(k) Plan, and we
17 strongly encourage them to do so, but they do not receive OTP defined contributions.
18 Rather, they are eligible to receive the OTP employer match, subject to the maximum
19 matching provisions I described above and as noted in Exhibit__(PEW-1), Schedule 5a.
20

21 Q. PLEASE DESCRIBE OTP'S PENSION PLAN.

22 A. OTP has a defined benefit pension plan that has two benefit formulas: (1) a benefit
23 formula for non-union and union employees, other than Coyote Station union employees;
24 and (2) a separate benefit formula for union employees at Coyote Station (collectively the
25 "Pension Plan"). A summary description of OTP's Pension Plan is provided in
26 Exhibit__(PEW-1), Schedule 5b. An overall retirement benefits eligibility summary is
27 provided in Exhibit__(PEW-1), Schedule 5c.
28

1 Q. DOES OTP PROVIDE OTHER POST-RETIREMENT EMPLOYEE BENEFITS
2 (OPEBS)?

3 A. Yes. OTP also provides a medical benefits program and life insurance for a limited
4 number of eligible retirees and a long-term disability medical plan for a limited number
5 of disabled employees. The life insurance benefit is no longer available to new
6 employees as a company-paid expense. Eligibility is restricted to those employees who
7 had 25 years of service with OTP as of January 1, 2003, and to Coyote Union employees
8 who were employees at the time OTP took over the operations of Coyote Station in 1998.
9

10 Q. HAS OTP TAKEN STEPS TO MANAGE THE COST OF ITS PENSIONS AND
11 OPEBS?

12 A. Yes. Since 2006, OTP has made significant changes to retirement benefits to control
13 costs. The first significant change eliminated eligibility to participate in the OTP Pension
14 Plan for employees hired after certain dates. This change is sometimes referred to as a
15 “soft freeze.” The effective dates of the soft freeze differ depending on bargaining-unit
16 status. For non-union employees, the soft freeze eliminated participation in the OTP
17 Pension Plan for employees hired after August 31, 2006. For the Coyote Plant
18 bargaining-unit employees, the soft freeze eliminated participation in the OTP Pension
19 Plan for employees hired after December 31, 2008. For our other bargaining-units, the
20 soft freeze eliminated participation in the OTP Pension plan for employees hired after
21 October 31, 2010. Employees who are not eligible for the OTP Pension Plan are eligible
22 to receive the OTP contributions to their 401k plan I described earlier in my Direct
23 Testimony.

24 The second significant change was the elimination post-retirement medical
25 benefits for new employees. Like the soft freeze on the OTP Pension Plan, this change
26 means that employees hired after certain dates are not eligible for post-retirement medical
27 benefits. Also, like the soft freeze on the OTP Pension Plan, the effective dates differed
28 based on bargaining unit status. For our non-union employees, this soft freeze was
29 effective for employees hired after August 31, 2006. For the Coyote Plant bargaining
30 unit, this soft freeze was effective for employees hired after December 31, 2008. For our

1 other bargaining-units, this soft freeze was effective for employees hired after
2 October 31, 2013. For all of these groups, participation is also limited to persons who are
3 age 55 or older at retirement with 10 or more years of service and eligible for or enrolled
4 in the OTP medical program as of retirement.

5
6 Q. WHAT HAS BEEN THE EFFECT OF THE SOFT FREEZE ON THE OTP PENSION
7 PLAN?

8 A. The soft freeze, in combination with retirements, is significantly reducing the number of
9 OTP employees participating in the OTP Pension Plan. As a result of the soft freeze on
10 the OTP Pension Plan, we now have 34 percent of our active employees who are not
11 participating in the OTP Pension Plan. We also have another 30 percent of our
12 employees who are age 55 or older. Our average retirement age is slightly below 62
13 years of age, so we would expect to have another 30 percent of our employee population
14 retire within the next seven years. As a result, we expect to move from 30 percent of
15 OTP employees outside the OTP Pension Plan to over 60 percent of our employees not
16 participating in the OTP Pension Plan within the next seven years.

17
18 Q. HAVE COSTS CONTINUED TO INCREASE FOR THE OTP PENSION PLAN AND
19 OPEB DESPITE THESE EFFORTS?

20 A. Yes. Cost increases related to the Pension Plan (FAS 87), Retiree Medical (FAS 106),
21 and Long-Term Disability Medical (FAS 112) have continued to increase and reflect the
22 effects of: (1) our employee population, with over 45 percent of our employees at 50
23 years of age and older; (2) lower-than-average discount rates over the past ten years; (3)
24 changing mortality tables; and (4) cost increases within the medical industry. The OTP
25 Pension Plan is designed to provide more significant benefits to longer-term employees,
26 and the post-retiree medical benefits do not start accruing until an employee reaches age
27 45. As a result, we will not see short-term cost savings as a result of the changes to the
28 Pension Plan and OPEBs, but we will see mitigated cost increases for our customers in
29 the long-term along with reduced volatility. We have also seen, in prior years, increases
30 in Long Term Disability Medical due to our aging workforce.

1 Q. HAS OTP BEEN PRUDENT IN ESTABLISHING AND THEREAFTER
2 CONTROLLING THE COSTS OF ITS DEFINED BENEFIT PENSION PLAN?

3 A. Yes. Defined benefit pension plans were very common when OTP established its defined
4 benefit pension plans in 1975, and OTP's decision to establish such a plan was prudent
5 and consistent with industry compensation and benefit practices. Since then, OTP has
6 continued to be prudent in managing its pension plans and other retirement benefits, as I
7 explained earlier. Most importantly, it has frozen participation in the Pension Plan.

8

9 Q. ARE OTP'S BENEFIT PLANS REASONABLE COMPARED TO THE MARKET?

10 A. Yes. Although there are no overall studies that compare total cash compensation plus
11 benefits between companies, the compensation and benefit studies that are available
12 demonstrate that the OTP compensation and benefit programs are reasonable. In addition
13 to the studies of cash compensation that I discussed earlier in my Direct Testimony, OTP
14 also routinely participates in the Willis Towers Watson Energy Industry BenVal Study.
15 A copy of the 2017 Willis Towers Watson Energy Industry BenVal Study (2017 BenVal
16 Study) is provided as NOT PUBLIC Exhibit ___(PEW-1), Schedule 6.

17

18 Q. PLEASE DESCRIBE THE 2017 BENVAl STUDY.

19 A. The 2017 BenVal Study focused on new hires and included 41 participating energy
20 services companies. The companies were further defined by revenue size. The 2017
21 BenVal Study showed that OTP's relative benefit value for non-bargaining unit
22 employees was 89 percent, or 11 percent below the average of the participating
23 companies. For bargaining unit employees, it was 99 percent, or 1 percent below the
24 average of the participating companies.

25

26 Q. WHAT ARE THE IMPLICATIONS OF HAVING A BENEFIT PACKAGE WITH A
27 LOWER BENEFIT VALUE?

28 A. It is possible that having a lower benefit value could inhibit OTP's ability to attract, retain
29 and engage the talented workforce needed to deliver safe and reliable electric service to
30 our customers. It is imperative that we continue to offer a compensation-and-benefit

1 package that is competitive for our employees and a good value to our customers. We
2 will continue to monitor our benefit package going forward to ensure it doesn't become a
3 detriment to our ability to attract, retain and engage quality employees.

4 **VI. 2017 EMPLOYEE COMPENSATION COSTS**

5 Q. PLEASE IDENTIFY THE COSTS OF OTP'S COMPENSATION PLAN THAT ARE
6 INCLUDED IN THE 2017 TEST YEAR.

7 A. The 2017 Test Year costs include: (1) OTP wages and salaries; (2) the OTP Annual
8 Incentive Plan, with the KPA Plan limited by average payout levels from 2013-2017, and
9 the Management Plan subject to a cap based on 25 percent of employees' salaries; (3)
10 OTP employee health and dental benefit plans; and (4) OTP costs relating to the Pension
11 Plan, the 401(k) Plan and OPEBs.

12 **A. Wages and Salaries**

13 Q. HOW WERE 2017 WAGE AND SALARY LEVELS DETERMINED?

14 A. The 2017 base wages and salaries are based on 2017 actual and adjusted for 2018
15 budgeted forecast with wage adjustments. The wage and the salary components for 2018
16 have also been adjusted for the projected employee census. The wage increases reflect
17 what OTP believes is necessary to remain competitive in the labor market in which it
18 competes. Accordingly, its primary purpose is to maintain competitive compensation
19 levels. It also addresses changes in the cost of living.

20
21 Q. PLEASE FURTHER EXPLAIN THE 2018 INCREASE FOR NON-UNION
22 EMPLOYEES OTHER THAN MANAGEMENT.

23 A. OTP budgeted for a 3 percent increase for non-union employees effective April 1, 2018.
24 The 3 percent increase is cumulative and individual employee increases will vary
25 depending on performance, market data, and where the employee's wage falls within the
26 respective wage range.

27

1 Q. PLEASE FURTHER EXPLAIN THE 2018 INCREASE FOR UNION EMPLOYEES.

2 A. OTP has two collective bargaining agreements (CBAs) representing approximately 390
3 union employees: (1) a CBA with four International Brotherhood of Electrical Workers
4 (IBEW) Local Unions representing approximately 329 employees; and (2) a CBA with
5 one IBEW Local Union representing approximately 61 Coyote Station employees. The
6 Coyote Station CBA was negotiated in 2017 and is effective September 1, 2017 through
7 August 31, 2020 with negotiated wage increases of 3.5 percent on September 1, 2017, 3.2
8 percent on September 1, 2018, and 3.1 percent on September 1, 2019. The CBA for the
9 other four IBEW Local Unions was also negotiated in 2017 and is effective November 1,
10 2017 through October 31, 2020 with negotiated wages increases of 3 percent on
11 November 1, 2017, 3 percent on November 1, 2018, and 3.25 percent on November 1,
12 2019.

13

14 Q. PLEASE FURTHER EXPLAIN THE 2018 INCREASE FOR MANAGEMENT AND
15 EXECUTIVE EMPLOYEES.

16 A. The 3 percent non-union wage increases effective April 1, 2018 include management and
17 executive employees. The 3 percent increase is cumulative and individual employee
18 increases will vary depending on performance, market data, and where the employee's
19 salary falls within the respective wage range.

20 **B. Incentive Compensation**

21 Q. HOW WAS THE OTP ANNUAL INCENTIVE PLAN COMPONENT OF THE 2017
22 TEST YEAR REVENUE REQUIREMENT DETERMINED?

23 A. The OTP 2017 Test Year revenue requirement includes amounts for the OTP KPA Plan
24 that was based on a 3.5 percent payout level, which is the five-year average payout level
25 for the OTP KPA Plan for 2013 through 2017, as shown on attached as Exhibit ___
26 (PEW-1), Schedule 7a. The OTP 2017 Test Year revenue requirement also includes an
27 amount for the OTP Management Plan, based on the five-year average, less any amounts
28 in excess of 25 percent of wages for each individual within that plan. NOT PUBLIC
29 Exhibit ___(PEW-1), Schedule 7b, illustrates application of the 25 percent cap for the

1 years 2013-2017. The 25 percent cap reduced the 2017 Test Year expense by \$127,301
2 (OTP Total) \$11,409 (OTP SD) from actuals for the OTP Management Plan and from the
3 plan for the OTP President.
4

5 Q. WHY IS IT APPROPRIATE TO INCLUDE THE COSTS OF THE OTP ANNUAL
6 INCENTIVE PLAN IN THE 2017 TEST YEAR REVENUE REQUIREMENT?

7 A. The costs of the OTP Annual Incentive Plan should be included in the 2017 Test Year
8 revenue requirement for several reasons. First, OTP's Annual Incentive Plan is an
9 important part of OTP's total compensation plan; without it, OTP's total cash
10 compensation would be significantly below market, making it harder for OTP to attract
11 and retain essential employees. Second, as I have explained earlier in my Direct
12 Testimony, the OTP Annual Incentive Plan includes an appropriate range and balance of
13 factors that provide benefits to customers. Third, including annual incentive plans in
14 total compensation packages is an established utility market practice. Fourth, OTP has
15 applied appropriate controls to the costs to be recovered in the revenue requirement.

16 When the 25 percent cap is applied, OTP's annual Total Cash Compensation and
17 Total Direct Compensation levels for executives are even further below competitive
18 market levels. The 2017 five-year average for the Management Plan, adjusted to remove
19 any amounts over a 25 percent cap on individual employee incentives, is appropriate for
20 determining OTP's 2017 Test Year revenue requirement. Using a five-year average
21 payout level for the OTP KPA Plan fairly represents OTP's typical payout levels over
22 time.

23 **C. Medical and Dental**

24 Q. WHAT IS THE BASIS FOR OTP'S 2017 TEST YEAR EMPLOYEE
25 MEDICAL/DENTAL, PENSION, DEFINED CONTRIBUTION AND OPEB COSTS?

26 A. OTP's employee medical/dental, pension, 401(k), and OPEB costs (sometimes
27 collectively "Benefit Costs") are based on 2017 actual, adjusted for 2018 budgeted
28 forecast. OTP's 2017 and 2018 pension (ASC 715) costs and OPEB (ASC 715 and ASC
29 712) costs are based on actuals by Mercer. OTP's pension costs are based on our

1 demographics and standard actuarial assumptions, using and applying ASC 715 and ASC
2 712 accounting standards.

3
4 Q. HOW DO OTP'S ACTIVE MEDICAL COSTS COMPARE BETWEEN 2016, 2017,
5 AND PROJECTED 2018?

6 A. Active medical costs increased between 2016 and 2017 by \$983,318 (OTP Total) /
7 (\$90,612) (OTP SD), and overall Group Insurance increased by \$1,423,616 (OTP Total) /
8 \$131,186 (OTP SD). Active medical costs are projected to decrease between 2017 and
9 2018 by (\$472,485) (OTP Total) / (\$43,539) (OTP SD), and they account for the majority
10 of decreases within overall Group Insurance (\$416,448) (OTP Total) / (\$38,376) (OTP
11 SD). Medical costs continue to be volatile and remain a common challenge across the
12 United States.

13
14 Q. DOES OTP USE PROJECTIONS TO DETERMINE ITS ACTIVE MEDICAL COSTS?

15 A. Yes. OTP has utilized third parties to determine active medical costs for many years and
16 has determined it to be an effective method to project future active employee medical
17 costs. The 2018 Renewal Results, prepared by Mercer, are provided as Exhibit ___(PEW-
18 1), Schedule 8.

19
20 Q. HOW DOES THE PROJECTED INCREASE FOR ACTIVE MEDICAL COSTS FOR
21 2018 COMPARE TO RECENT EXPERIENCE?

22 A. The move to high deductible health plans along with an increase to the employees' cost
23 share of the premiums has helped to keep the increase in overall medical costs below
24 current medical cost trends. The projected active medical costs increase between 2016
25 and 2018 is 5.6 percent (OTP Total). Costs increased by 10.7% between 2016 and 2017
26 and are projected to decrease between 2017 and 2018. The size of our health care plans
27 does create some volatility, year over year, but we know our move to the HDHP in 2012
28 means we have spent less than we would have had we stayed on our previous health care
29 plan. Nationally, health care costs continue to trend upward and OTP will continue to
30 look at plan design changes, premium structures and other alternatives to mitigate future

1 health care spending. Other alternatives include the continued promotion of preventive
2 health care and wellness which help to reduce health care costs over the long-term. OTP
3 does, however, intend to provide a quality health care benefit at a reasonable price for our
4 employees, in our effort to attract, engage and retain quality employees in the coming
5 years.

6 **D. Pension and Benefits**

7 Q. HAVE PENSION COSTS INCREASED BETWEEN 2016 AND 2018?

8 A. Yes. Pension costs between 2016 and 2017 increased by approximately \$141 thousand
9 (OTP Total / \$12 thousand (OTP SD)). The actual 2018 pension costs have increased by
10 approximately \$300 thousand (OTP Total) / \$26 thousand (OTP SD) between 2016 and
11 2018.

12
13 Q. DOES MERCER REGULARLY PERFORM ACTUARIAL ANALYSES FOR OTP?

14 A. Yes. Mercer performs annual analyses of OTP's pension and OPEB costs. Annual
15 actuarial analyses of pension and OPEB obligations are performed to satisfy several legal
16 requirements including: (1) ERISA, which requires annual actuarial reports regarding
17 pensions be filed with the Department of Labor; (2) the pension Benefits Guarantee
18 Corporation, which also requires annual actuarial reports regarding Pension funding
19 status; (3) the Internal Revenue Service, which requires filing of an annual actuarial
20 report as part of Form 5500; and (4) the Securities Exchange Commission, which requires
21 disclosure of actuarial analyses of pensions and OPEBs in annual Form 10-K filings.
22 These legal requirements underscore the fact that the Mercer actuarial analyses are
23 reliable and independent assessments of anticipated pension and OPEB expenses. The
24 data relied on in this proceeding for actual 2018 pension and OPEB expenses conforms to
25 these standards.

26

1 Q. WHAT ARE THE PRIMARY SOURCES OF THE INCREASE IN ASC 715 PENSION
2 COSTS (FORMERLY FAS 87) BETWEEN 2016 AND 2018?

3 A. The most significant factor is the decrease in the discount rate, or interest rate, used to
4 determine present value of future benefit obligations. The lower discount rate means a
5 lower interest rate and results in both an increased service cost and projected benefit
6 obligation. The lower discount rate requires more cash today to meet future benefit
7 obligations within the pension plan.

8 Another factor contributing to the increase is a decreased mortality rate, reflecting
9 increased life expectancies. A decreased mortality rate results in an expectation that
10 pension benefit payments will occur over a longer period, increasing expense.

11 The Estimated Return on Assets (EROA) will be an offset to pension expenses
12 and the increase in the pension asset (resulting from both growth and the increase in the
13 prepayments by OTP) limited the increase in the expense.

14
15 Q. HOW DO OTP'S COSTS FOR ASC 715 POST-RETIREMENT MEDICAL/LIFE
16 (FORMALLY FAS 106) AND ASC 712 POST-EMPLOYMENT (LTD) MEDICAL
17 (FORMALLY FAS) COMPARE BETWEEN 2016, 2017, AND 2018?

18 A. ASC 715 Post-Retirement Medical/Life costs increased between 2016 and 2018 by
19 approximately \$1.4 million (OTP Total) / (\$129,520 (OTP SD), with much of the
20 increase occurring between 2016 and 2017. ASC 712 Long-Term Disability costs
21 decreased by approximately \$197,000 (OTP Total) / \$18,837 (OTP SD), with much of
22 the decrease occurring between 2016 and 2017

23
24 Q. WHAT WAS THE BASIS OF OTP'S PROJECTED ASC 715 POST-RETIREMENT
25 MEDICAL INCREASES FROM 2016 TO 2018?

26 A. OTP experienced the majority of the increase in Post-Retirement Medical/Life expense in
27 2017, primarily related to aging demographics within our employee group, along with
28 medical cost expectations. The 2018 actuals for Post-Retirement Medical/Life is slightly
29 higher than 2017 but is still an increase over 2016 actuals.

30

1 Q. ARE ASC 712 POST-EMPLOYMENT MEDICAL (LTD)EXPENSES SENSITIVE TO
2 PARTICIPANT COUNTS?

3 A. Yes. Long Term Disability medical liability is very sensitive to participant counts. Just
4 one or two participants can have a significant impact on plan liability. Moreover, OTP is
5 required to recognize actuarial gains and losses immediately; changes in liability based
6 on participant count changes and claims experience are fully recognized in the year they
7 occur. These factors are considered as part of Mercer’s actuarial projections for ASC
8 712.

9
10 Q. HAVE YOU INCLUDED THE MERCER REPORTS ON WHICH YOU HAVE
11 BASED 2018 COSTS FOR PENSION, POST RETIREMENT MEDICAL, AND LONG-
12 TERM DISABILITY BENEFITS?

13 A. Yes. I have attached Exhibit__(PEW-1), Schedule 9a – 2018 ASC 715 and ASC 712
14 Accounting Expense Report – Mercer NOT PUBLIC; Exhibit__(PEW-1), Schedule 9b
15 – 2017 Pension DAMP – Mercer; and Exhibit__(PEW-1) NOT PUBLIC, Schedule 9c –
16 2017 Post-retirement Medical and LTD Medical DAMP – Mercer NOT PUBLIC which
17 provide the basis for those 2018 costs.

18 **VII. CONCLUSION**

19 Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.

20 A. OTP has structured a reasonable total cash compensation and benefits package that is
21 needed in order to attract and thereafter retain and engage talented employees necessary
22 to provide high quality electric service to our customers. This includes base salaries,
23 active and post-retirement benefits, and incentive compensation. OTP’s proposed
24 compensation and benefit costs included for rate making are fair and reasonable.

25
26 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

27 A. Yes.