

**STATE OF MICHIGAN**

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

\* \* \* \* \*

In the matter of the application of )  
**UPPER PENINSULA POWER COMPANY** )  
for authority to increase retail electric rates. )  
\_\_\_\_\_ )

Case No. U-16417

DIRECT TESTIMONY AND EXHIBITS OF

NOREEN E. CLEARY

FOR

UPPER PENINSULA POWER COMPANY

June 30, 2011

**STATE OF MICHIGAN**

**BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION**

\* \* \* \* \*

In the matter of the application of )  
**UPPER PENINSULA POWER COMPANY** )  
for authority to increase retail electric rates. )  
\_\_\_\_\_ )

Case No. U-16417

**QUALIFICATIONS  
OF  
NOREEN E. CLEARY  
PART I**

1 **Q. Please state your name, business address and position.**

2 **A.** My name is Noreen E. Cleary. My business address is Integrys Business Support,  
3 LLC, 130 E. Randolph Drive, Chicago, IL 60601. I am the Assistant Vice President,  
4 Total Compensation for Integrys Energy Group, Inc. Upper Peninsula Power  
5 Company (“UPPCO”) is a wholly-owned subsidiary of Integrys Energy Group, Inc.  
6 (“Integrys”).

7

8 **Q. For whom are you providing testimony?**

9 **A.** I am providing testimony on behalf of UPPCO.

10

11 **Q. Please describe briefly your educational, professional, and utility background.**

12 **A.** I received a Bachelor’s of Science in Medical Technology from Fitchburg State  
13 College, now Fitchburg State University, in 1981. I have worked in Human  
14 Resources for various public companies for the past 24 years. I have specialized in  
15 the areas of Compensation and Benefits during this time period. I hold a  
16 Compensation Management Specialist (“CMS”) as well as a Certified Employee  
17 Benefit Specialist (“CEBS”) designation from the International Foundation of  
18 Employee Benefits Programs (“IFEBC”) in partnership with the Wharton School of

1 the University of Pennsylvania. In addition, I am an ISCEBS Fellow of the  
2 International Society of Certified Employee Benefits Specialists.

3

4 **Q. Have you previously testified before any regulatory agency?**

5 A. Yes, I have. I have testified before the Minnesota Public Utilities Commission  
6 ("MPUC") on behalf of Minnesota Energy Resources Corporation ("MERC") in rate  
7 case Docket No. G007,011/GR-10-977; and before the Illinois Commerce  
8 Commission on behalf of The Peoples Gas Light and Coke Company and North  
9 Shore Gas Company in Docket Nos. 11-0280/0281 (Consolidated).

**NOREEN E. CLEARY  
DIRECT TESTIMONY  
PART II**

1 **Q. What is the purpose of your pre-filed direct testimony?**

2 A. The purpose of my pre-filed direct testimony is to discuss the design structure of the  
3 Integrys 2011 Non-Executive Incentive Plan (“UPPCO incentive plan”). Employees  
4 of UPPCO, as well as employees of Integrys Business Support, LLC (“IBS”),  
5 participate in the Integrys 2011 Non-Executive Incentive Plan utilizing specific  
6 measures and targets designed for UPPCO. IBS is a separate subsidiary of Integrys  
7 that provides various shared services and corporate support to UPPCO. The focus  
8 of this non-executive incentive pay plan differs from that of previous UPPCO  
9 incentive pay plans. Significant changes have been made to the design of  
10 measurement criteria which now focus solely on the customer.

11

12 **Q. Are you sponsoring any exhibits in this proceeding?**

13 A. Yes, I am. I am sponsoring Exhibit A-10 (NEC-1), which is the Integrys 2011 Non-  
14 Executive Incentive Pay Plan.

15

16 **Q. Was this exhibit prepared by you or under your direction and supervision?**

17 A. Yes, it was.

18

19 **Q. Please summarize the changes to the UPPCO incentive plan.**

20 A. The UPPCO incentive plan, as redesigned, is based only on metrics focused on  
21 providing benefits to customers in the form of (i) reducing expenses, (ii) creating  
22 greater efficiencies in operations, (iii) increasing customer satisfaction and (iv)  
23 improving reliability. This re-design of the UPPCO Incentive Plan is based on  
24 Integrys re-considering its incentive plans in light of regulatory decisions about  
25 recovery of incentive plan expenses and removes those aspects of incentive plans

1 that have been the subject of concern. As redesigned, the UPPCO incentive plan  
2 can reasonably be expected to provide tangible net benefits to ratepayers so that the  
3 recovery of the costs for UPPCO's incentive plan would be just and reasonable.

4

5 **Q. Please describe UPPCO's compensation Philosophy.**

6 A. Like most customer-focused businesses, including public utilities, UPPCO maintains  
7 compensation programs that are market-based so it can attract and retain a qualified  
8 and motivated work force. UPPCO compete for quality employees in a market that  
9 includes regulated and non-regulated energy companies as well as non-energy  
10 firms. Virtually all firms with which UPPCO competes for quality employees offer  
11 incentive pay as a portion of total compensation. UPPCO's cash compensation goal  
12 is to pay our employees a total cash compensation package (base pay plus target  
13 incentive pay) that is anchored to market median levels, as compared to other  
14 energy industry companies. UPPCO defines the market median as the 50th  
15 percentile of competitive data as provided by Towers Watson consultants. Towers  
16 Watson is an internationally recognized firm that specializes in both compensation  
17 and benefits consulting services.

18

19 **Q. Please describe how your compensation programs currently compare with**  
20 **similar companies.**

21 A. These compensation programs are constantly reviewed against competitive data.  
22 This review includes both market data and business objectives to assure the  
23 compensation programs will attract and retain a quality work force to serve UPPCO  
24 customers. Base pay targets and annual incentive payout targets have been aligned  
25 with the 50th percentile median of comparable energy industry as well as general  
26 industry companies. Stated another way, the combination of the base pay target  
27 plus annual target incentive payout brings the employee's total cash compensation

1 target to the 50th percentile (median) of comparable energy industry and general  
2 industry companies.

3

4 **Q. If the Commission does not allow full recovery of incentive pay costs, why**  
5 **couldn't UPPCO simply pay its employees exclusively through base pay?**

6 A. There are two reasons why UPPCO needs to use an incentive compensation  
7 package rather than pay employees exclusively through base pay. First, offering  
8 only base pay plans without an incentive pay component would make it more difficult  
9 for UPPCO to attract the quality employees required to provide a level of service that  
10 our customers demand. Indeed, surveys performed by Towers Watson have  
11 concluded that the majority of companies extend their incentive programs deep into  
12 their organizations (i.e., at least to entry level professionals). Second, including  
13 annual incentive plans in its compensation program enables UPPCO to offer  
14 competitive compensation packages that incent employees to improve service levels  
15 and reduce costs that impact the rates paid by customers. The 2011 incentive plan  
16 design will focus employees on key goals and objectives that benefit UPPCO  
17 customers, as its design measure criteria will concentrate on cost containment and  
18 operational goals that are aligned with the interests of customers rather than financial  
19 measures that might be more aligned with the interests of shareholders.

20

21 **Q. Does a utility's ability to attract and retain sufficient, qualified and motivated**  
22 **work force benefit customers?**

23 A. Absolutely. Attracting and retaining a sufficient, qualified and motivated work force  
24 directly benefits customers, because it ensures there are enough highly proficient  
25 employees to perform needed customer work. In addition, maintaining and  
26 improving the productivity and quality of work performed reduces overall costs to rate  
27 payers and improves customer satisfaction. By retaining trained and experienced

1 employees, UPPCO is able to avoid incurring the additional costs of hiring and  
2 training employees to replace workers who otherwise would choose to leave the  
3 company. Additionally, experienced employees who are familiar with UPPCO's  
4 systems and equipment tend to be more efficient in their performance, further  
5 reducing the company's operating and maintenance expenses and capital  
6 expenditures.

7

8 **Q. How is UPPCO planning to modify its current non-executive incentive plan**  
9 **design?**

10 A. Beginning with the 2011 non-executive incentive plan, UPPCO will continue to  
11 maintain a plan based on a scorecard of key measurement criteria which we believe  
12 are in our customers' best interests. However, the measurement criteria are now all  
13 operational, as we have eliminated the portion of the incentive plan expenses that  
14 used financial-specific measures that have been of concern to commissions which  
15 regulate Integrys affiliates as focused on benefiting shareholders rather than  
16 customers. UPPCO's measures assess cost control via non-fuel Operations and  
17 Maintenance ("O&M") expense-adjusted which is weighted at 50% of the total.<sup>1</sup> In  
18 addition, customer service, system reliability and employee safety measurements are  
19 weighted at a combined 50% of the total. The plan design will focus employees  
20 entirely on metrics that benefit the customer. Table 1 is a high-level review of the  
21 plan design.

22

<b>TABLE 1</b>
<i>Operational Measures</i>

---

<sup>1</sup> The "adjustments" to the O&M levels used for the incentive plan are based upon annual incentives, pre-tax impact of adjustments in earnings guidance, and costs recovered directly through regulatory trackers.

Cost Control Non-fuel O&M Expense Adjusted	Employee Safety- OSHA-Recordable Incident Rates	Customer Satisfaction	Reliability
50%	15%	15%	20%

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19

**Q. What portion of UPPCO’s prior incentive plan focused on these types of measures?**

A. Before this change to the 2011 incentive plan, 50% of the incentive plan expenses were paid out based on non-financial metrics, and 50% of the incentive plan expenses were paid out based on the overall financial performance of Integrys.

**Q. What is the focus of these operational measures?**

A. UPPCO operational measures are focused on improving services delivered to customers including cost control of expenses that impact their rates. They are designed to motivate employees to maintain customer support at a high quality level and at reasonable rates.

**Q. Please review the planned make up of UPPCO’s non-executive incentive plan?**

A. The 2011 incentive pay program rewards non-union employees on an annual basis for meeting pre-determined goals in a number of areas. Table 2 provides details on the four operational measures.

<b>TABLE 2</b>		
<i>Operational Measure</i>	<i>Description</i>	<i>Weighting</i>
1. <u>Cost Control</u>	Combined IBS and Integrys Utilities Non-Fuel O&M Expense-Adjusted	50%
2. <u>System Reliability</u>	Based on SAIDI, excluding major storms.	20%

<b>TABLE 2</b>		
<i>Operational Measure</i>	<i>Description</i>	<i>Weighting</i>
3. <u>Employee Safety</u>	Based on reducing OSHA recordable injuries and illnesses.	15%
4. <u>Customer Satisfaction</u>	Based on improving customer satisfaction, a residential customer survey measures overall customer satisfaction in categories such as reliability, communications, corporate citizenship, price and value, billing and payment, customer and field service. This measure compares UPPCO's score against the Midwest regional utilities' average score. UPPCO's previous year ratio is used as a starting point for goal setting. Surveys will be conducted by J.D. Powers.	15%

1

2

3 **Q. Who participates in the incentive plan?**

4 A. Participants in the incentive plan include UPPCO non-union non-executive  
 5 employees, as well as employees of IBS. Employees of IBS effectively participate in  
 6 the incentive plan as the IBS goals include the System Reliability, Employee Safety,  
 7 and Customer Satisfaction metrics of UPPCO and the other Utility Affiliates,  
 8 weighted based on the proportion that IBS costs are generally allocated to each  
 9 Utility Affiliate, including UPPCO. IBS employees' incentive goals also include the  
 10 cost control measure.

11

12 **Q. Please explain how the redesigned incentive pay no longer relates to net**  
 13 **income.**

14 A. UPPCO's 2011 non-executive incentive plan now focuses all of its measurement  
 15 elements on goals that directly benefit customers. The UPPCO Incentive Plan has  
 16 eliminated the previous "financial" measure (i.e., consolidated calculated net  
 17 income), the consolidated calculated net income earnings governor, and the  
 18 connection to affiliated company non-financial performance.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27

First, 50% of UPPCO’s previous incentive compensation plan was based upon the achievement of specified consolidated calculated net income targets for UPPCO’s parent company, including UPPCO itself, Integrys’ combined regulated subsidiaries, and affiliate Integrys Energy Services. This measurement has now been changed to focus on combined utility and IBS non-fuel O&M adjusted expenses.

Second, UPPCO’s previous incentive compensation plan included a consolidated calculated net income governor on the plan’s performance goals whereby any earned performance goal payouts would be reduced by 50% if a consolidated calculated net income threshold level was not reached by Integrys (UPPCO’s ultimate parent company). This governor has been removed from the 2011 plan.

Third, UPPCO’s previous incentive compensation plan included a provision granting the Integrys Board of Directors/Chief Executive Officer the power to modify or cancel the incentive compensation plan, including the associated payments, at their discretion. This provision has been eliminated, and all earned incentive compensation will be paid to employees.

Finally, non-financial performance is now focused on UPPCO results as related to satisfaction of customers, employee safety results, and system reliability.

**Q. On what do you base your conclusion that recovery of the costs of 2011 UPPCO incentive plan is reasonable?**

A. As described above, the 2011 UPPCO incentive plan contains measures designed to provide net benefits to ratepayers by encouraging the achievement of operational goals focused on reducing costs and improving reliability and service.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29

In addition, as described on page 20 of the Commission’s April 28, 2005 Opinion and Order Granting Rate Relief in Case No. U-13898, the Commission stated:

“the Commission determined that executive bonus and employee incentive plans require a showing that the plan will not result in excessive rates and that the benefits to ratepayers from the bonus and incentive plans, at a minimum, will be commensurate with the programs costs”.

UPPCO believes that the redesigned incentive compensation plan meets both of these requirements.

**Q. On what do you base your conclusion that the employee incentive plans do not result in excessive rates?**

A. As shown on Exhibit A-8 (SSD-5), UPPCO is requesting recovery of \$729,263 of incentive compensation costs for 2012. This equates to 0.67% of the total retail revenue requirement in 2012.

**Q. On what do you base your conclusion that the employee incentive plans, at a minimum, will be commensurate with the program costs?**

A. The Integrys incentive plan contains three levels, “threshold”, “target” and “superior”. Under the redesigned plan, there is no payout for non-fuel O&M cost savings below the “threshold” level.

Under the redesigned plan, the Integrys subsidiaries as a whole must achieve \$35.4 million in non-fuel O&M cost savings to trigger an incentive payout at the Integrys “target” amount. UPPCO’s allocation of these non-fuel O&M cost savings would be 4.42%, or \$1.6 million, assuming the non-fuel O&M savings were achieved evenly across all Integrys subsidiaries. Under this scenario, UPPCO would recognize

1 savings of \$1.6M in non-fuel O&M costs, and incur only approximately \$0.7 million of  
2 incentive compensation costs, resulting in a net benefit of approximately \$0.9 million  
3 to UPPCO, which would reduce or delay the need for future rate increases.

4  
5 Similarly, under the redesigned plan, the Integrys subsidiaries as a whole must  
6 achieve \$70.7 million in non-fuel O&M cost savings to trigger an incentive payout at  
7 the Integrys “superior” amount. UPPCO’s allocation of these non-fuel O&M cost  
8 savings would be 4.42%, or \$3.1 million, assuming the non-fuel O&M savings were  
9 achieved evenly across all Integrys subsidiaries. Under this scenario, UPPCO would  
10 recognize savings of \$3.1M in non-fuel O&M costs, and incur only approximately  
11 \$0.7 million of incentive compensation costs, resulting in a net benefit of  
12 approximately \$2.4 million to UPPCO, which would reduce or delay the need for  
13 future rate increases.

14  
15 The analysis above is based on the 2011 incentive plan metrics, and the metrics for  
16 2012 have not yet been approved.

17  
18 **Q. Have any other state regulatory agencies expressed an opinion regarding the**  
19 **reasonableness of cost recovery of the redesigned Integrys incentive**  
20 **compensation plan in utility customer rates?**

21 A. Minnesota Department of Commerce witness Ms. Michelle St. Pierre stated the  
22 following in her Direct Testimony in UPPCO affiliate Minnesota Energy Resources  
23 Corporation (“MERC”) pending general rate case in Docket No. G007,011/GR-10-  
24 977;

25  
26 “I conclude that the measurement criteria for non-executive plans  
27 are now all operational rather than being based on the financial  
28 performance of Integrys. Therefore I conclude that MERC’s  
29 redesigned non-executive plan has reasonable performance goals.”  
30

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27

Ms. St. Pierre further recommends full recovery of the costs of the Integrys non-executive incentive compensation plan in MERC's 2011 customer rates. She also recommends 30% recovery of the Integrys executive incentive compensation plan costs in MERC's 2011 customer rates.

**Q. Do you have any additional comments on the recovery of the incentive pay costs?**

A. Yes, I do. As with all incentive based compensation plans, there is no guarantee to this pay-at-risk compensation component, as it is totally reliant on company performance and only paid if performance levels are met or exceeded. If payment is guaranteed, then there would be no incentive for employees to meet the goals designated by the employer. The goals contained in UPPCO's incentive plan are reasonably attainable, however. Moreover, if the Commission disallows recovery of these expenditures and the disallowed amounts continue to grow, it will potentially impact our service levels. UPPCO may ultimately have to go to a more fixed-expense basis for compensation in the form of increased base salaries in order to be competitive. This would put UPPCO at a disadvantage in a market where incentive pay-at-risk programs are prevalent. The opportunity to earn pay-at-risk is critical in order to maintain a competitive position in the marketplace and to attract and retain the highly proficient employees necessary to perform needed customer work. UPPCO's total cash compensation design is targeted to meet the energy industry and the general industry market median compensation rates. This includes base salary and incentive pay at target performance levels. These are prudent expenditures that allow UPPCO to continue customer-expected service levels and to maintain competitive rates.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27

**Q. If UPPCO does not earn a “pay-out” from the Integrys incentive compensation plan, should customers pay for these costs in rates?**

A. No, UPPCO does not believe customers should pay for these costs in rates in the event that UPPCO does not (“pay-out”) incur costs associated with the incentive compensation plan. Therefore, UPPCO is proposing the creation of an incentive compensation tracker and refund mechanism.

Under the incentive compensation tracker, each year UPPCO will record the difference between the amount of incentive compensation that is actually paid to executive and non-executive employees, on a combined basis, and the amount of incentive compensation that is included in UPPCO’s 2012 revenue requirement for executive and non-executive employees, on a combined basis. Any cumulative net under-payments of incentive compensation, on a combined basis, will be amortized and refunded to UPPCO’s customers in future general rate case proceedings, including carrying costs at UPPCO’s prevailing short-term debt rate. Any cumulative net over-payments of incentive compensation, on a combined basis, will be expensed by UPPCO, and will not be recovered from UPPCO’s customers.

Any carrying charges would commence with the initial accounting entries recorded to the proposed incentive compensation tracker.

The use of the proposed incentive compensation tracker would alleviate concerns regarding UPPCO’s ability to potentially divert money targeted for the incentive compensation plans to other areas. At the same time, it would take into account the typical variations in annual incentive compensation, and allow any under-payment of incentive compensation to be addressed in the already well-established utility rate-

1 making process.

2

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

4 A. Yes, it does.