

1 **3. Q: Have you filed testimony in any other proceeding?**

2 **A:** Yes. I have previously presented and/or filed testimony as a witness
3 before the Delaware Public Service Commission (the Commission or PSC) in
4 Docket No. 09-414.

5 **4. Q: What is the purpose of your testimony in this proceeding?**

6 **A:** The purpose of my testimony is two-fold. First, I will testify on the topic
7 of non-executive and executive compensation; how they are competitive,
8 reasonable and appropriate business expenses. I will specifically focus on the
9 purpose of the Company's incentive program and the comparison of the
10 Company's program to that of its peer group.

11 Second, I will address the escalator factors related to the employee
12 benefits: medical, vision and dental and comment on their reasonableness. I will
13 explain how the Company develops and maintains economically competitive
14 salary and benefit structures which result in safe and reliable gas service to our
15 customers. In the end, my testimony will indicate that our business practices in
16 these areas are both in the stockholders' and the customer's interest. In his
17 testimony, Company Witness VonSteuben focuses on the ratemaking treatment of
18 these items.

19 **5. Q: Please describe the Company's strategy in designing compensation and**
20 **benefits programs.**

21 **A:** Compensation and benefits are the key components that enable all
22 businesses, including Delmarva Power, to attract and retain skilled employees at
23 all levels of the organization. Delmarva Power actively competes for skilled
24 employees in the marketplace, and to the extent that Delmarva's overall

1 compensation program lags the market, it impacts Delmarva's ability to both
2 recruit and retain skilled employees, to the detriment of our customers. It is
3 Delmarva's intent to retain skilled employees in the Gas Division as in all other
4 areas of the PHI organization. If compensation and benefit offerings are below
5 the market, the higher skilled employees will be drawn to employers offering
6 superior compensation and benefits. Over time, if the Company attempts to hire
7 employees at a below market rate, the overall quality of skills and motivation
8 levels of the workers could result in a downward trend in safety and reliability of
9 the gas operation system.

10 **6. Q: How does the Company determine whether its executive and non-executive**
11 **compensation and benefits programs are competitive?**

12 **A:** The Company retains the services of external expert consultants to assist
13 in performing an external benchmarking evaluation of all non-union positions
14 every two years, and executive positions annually. Pearl Meyer and Partners
15 conducts executive benchmarking and Towers Watson assists the Company with
16 non-executive benchmarking.

17 **7. Q: Please describe the benchmarking process.**

18 **A:** Management assists the consultant in understanding the roles and
19 responsibilities of each of the positions and the key markets that should be
20 considered in benchmarking each job, based on the Company's recruiting efforts.
21 For example, some positions are unique to utility operations, and others are
22 positions that are also common to other non-utility firms. For positions that are
23 not unique to utilities, the consultant also considers market data provided by

1 general industry companies in addition to utility data. Competitive compensation
2 data are analyzed using the median (50th percentile) statistics.

3 The Company designs its compensation plan to be in the middle of the
4 competitive labor market. In other words, our compensation package is intended
5 to be neither at the high end nor the low end of the markets in which we compete
6 for labor resources. Based on the job evaluations, position information, and
7 market definitions for each position, the consultant develops competitive market
8 data for each position. These market data include both salary and incentive
9 compensation for each position. The consultant also assists the Company in
10 making recommendations on updating its management salary structure
11 (commonly known as salary ranges and levels) based on the market data. Each
12 position is assigned a salary range from minimum to maximum, and also an
13 incentive compensation target. Each position also is assigned to a salary level
14 within the salary structure.

15 **8. Q: How does the Company use the salary ranges developed through**
16 **benchmarking?**

17 **A:** The salary ranges are used by the Company when making decisions
18 regarding the pay for new and existing employees. Actual salaries are
19 determined based on the experience and performance of the employees, and the
20 supply and demand for employees with particular skills and abilities in the
21 market.

22 **9. Q: Please describe the results of the most recent non-executive market**
23 **evaluation that was completed in 2009.**

1 **A:** Overall, the study found that PHI’s compensation program is competitive
2 and consistent with utility and general industry practices. However, exceptions
3 were noted. For example, for non-executive positions, our incentive targets are
4 below market levels for higher graded positions, and our current compensation
5 program has limited ways to recognize and award individuals for the quality of
6 their performance. In other words, when it comes to what are usually referred to
7 as “incentives” PHI’s and Delmarva’s compensation programs are below or
8 nonexistent to those of the average company in the industry.

9 **10. Q: Does the Company follow a similar competitive market evaluation process**
10 **for executive positions?**

11 **A:** Yes. The Compensation/Human Resources Committee of the PHI Board
12 of Directors retains an independent consultant, Pearl Meyer and Partners, to
13 assist it in the design of executive compensation programs. The benchmarking
14 process for executive positions is essentially the same as for non-executive
15 compensation; however, the market typically provides executive positions with
16 additional executive compensation elements not typically provided to non-
17 executives.

18 **11. Q: What are the additional executive compensation elements you reference?**

19 **A:** Long-term incentives in the form of Company stock are a common
20 element that is expected by the market in designing compensation for executives
21 in investor owned companies.

22 This plan promotes the long-term business interest of the Company and its
23 customers. These objectives include providing safe and reliable service to our
24 gas customers. Additionally, the market typically provides programs that allow

1 executives to not be penalized by benefits limits established by the IRS, such as
2 limits on qualified pensions and contributions to qualified salary deferral plans
3 commonly referred to as (401k) plans.

4 The market also typically provides executives with certain perquisites that
5 assist firms in attracting and retaining executive talent. Examples of these
6 perquisites are transportation allowances or usage of Company vehicles, and
7 services such as financial and tax planning, and executive physicals. These
8 perquisites facilitate the transportation of executives to and from Company
9 facilities and community-related events in a cost effective and reliable manner.
10 The financial planning, tax preparation, and executive physicals perquisites are
11 designed to allow the executive to keep undivided attention on the needs of the
12 organization and to promote wellness of the executives, to the benefit of the
13 Company and its customers.

14 **12. Q: What conclusions did the Committee's consultant make regarding total**
15 **direct compensation for PHI executives for 2009?**

16 **A:** As described in the Compensation Discussion and Analysis section of the
17 Proxy Statement and 2008 Report to Shareholders, Pearl Meyer and Partners
18 commented that total direct compensation (salary + annual bonus + long-term
19 incentive) for executive officers was somewhat below the midpoint of the
20 competitive market median range of practices. The consultant concluded,
21 however, that the total compensation and benefits for the executive officers
22 including retirement plans and other benefits were reasonable, and did not
23 recommend an increase in long-term incentive targets for 2009.

24 **13. Q: Please describe the cost trends for the Company's employee benefits.**

1 **A:** The Company contracted benefit consultant Lake Consulting, Inc. to
2 explore the expected medical benefits increase as a percentage increase over the
3 test period. Lake Consulting determined that an increase in medical expense by
4 8% and dental and vision expense by 5% were reasonable and appropriate as a
5 result of their research.

6 As previously described, PHI engages an independent consultant to
7 confirm that its benefits are adequate to attract the talent necessary to maintain a
8 financially stable organization, attract necessary investment, and provide safe
9 and reliable service to our customers. The studies performed by our consultant
10 have shown that PHI manages its benefit costs in an effective and efficient
11 manner and has done so consistently.

12 **14. Q: What recent actions has the Company taken to control medical and related**
13 **employee benefit costs?**

14 **A:** The Company has been diligent in managing and containing the costs of
15 benefits for all employees. The listing below captures these efforts for the
16 calendar years 2005 to 2010.

17 **PHI - BENEFIT COST CONTAINMENT INITIATIVES**

18 **2005**

- 19 • Implementation of a new defined benefit plan for all Management and Local 1900
20 new hires
- 21 • Redesigned healthcare benefits for management and Local 1900 employees
 - 22 ○ Eliminated indemnity plans; added 3-tier coinsurance prescription plan
- 23 • Redesigned retiree healthcare plans for Management and Local 1900
 - 24 ○ Increased contribution levels (same as active employees)
 - 25 ○ Added retiree cost caps that limit PHI's exposure and Medicare carve-out

- 1 ○ Removed subsidy for Management and Local 1900 employees hired after
- 2 1/1/05

3 **2006**

- 4 • Moved all Conectiv heritage retirees into the new PHI Retiree Welfare Plan
- 5 • Delmarva Union (Local 1238 & L1307) negotiations resulted in medical plan
- 6 savings
 - 7 ○ Increased deductibles, Rx co-pays and 80/20 employee cost share
- 8 • Re-bid dental insurance plan
 - 9 ○ Decreased administrative fees
 - 10 ○ Negotiated new network with deeper discounts

11 **2007**

- 12 • Moved all ACE retirees into the new PHI Retiree Welfare Plan
- 13 • ACE Union (L210) negotiations resulted in medical plan savings
- 14 • Re-bid life insurance plan
- 15 • Implemented centralized case and disease management program

16 **2009**

- 17 • Re-bid medical plans for all active and retirees
 - 18 ○ Reduced administrative fees and gained deeper discounts, effective 1/1/10
 - 19 ○ Extended prescription plan contract
 - 20 ○ Reduced mental health plan administrative fees

21 **2010**

- 22 • Increased co-pays and deductibles in medical plans for Management, Local 1900
- 23 and retirees

- 1 • Implemented incentives for mail order and generic Rx utilization

2 **15. Q: Is a Pension Plan part of the employee total compensation package?**

3 **A:** Yes, it is. The Company's pension plan has evolved over time, and
4 several changes have been made over the years. In 1999, Conectiv implemented
5 a low cost cash balance pension plan for all management employees. In 2005,
6 PHI implemented a low-cost annuity defined benefit plan (PHI sub-plan) for all
7 new management employees (comparable in cost to a cash balance plan, but
8 without the lump sum payment option). Further, PHI eliminated all retiree health
9 and welfare benefits for management and local 1900 employees hired after
10 January 1, 2005. The Company has demonstrated its commitment to monitoring
11 and containing retirement costs.

12 **16. Q: Please describe the purpose of the Company's incentive compensation**
13 **program.**

14 **A:** The Company's performance incentive plans are part of employees' total
15 compensation package. Delmarva could simply increase base salaries and
16 provide no incentives. Instead, leadership has decided to pay a lower base salary
17 while providing opportunity for our employees to earn an additional reward
18 based upon performance. Having a portion of employees' compensation based
19 upon performance (or at-risk) is an accepted and widely used mechanism which
20 motivates employees to be more efficient and productive.

21 For Delmarva Power, this program helps to focus employees' attention
22 and efforts on achieving the Company's goals. Many of these goals are
23 explicitly customer-oriented. To the extent that other goals are financial in

1 nature, such goals help motivate employees to keep costs down and ultimately,
2 benefits customers in the ratemaking process.

3 While the specifics of the annual incentive program differ from job to job,
4 or among levels, they all have the same fundamental framework of drivers. In
5 particular, all of the programs have employee measures such as safety. All of
6 the programs also have customer satisfaction components including for example,
7 such factors as measurements from the Market Strategies, Inc. (MSI) survey and
8 field surveys of customers who have had recent interactions with the Company.
9 Reliability measures are also included. The programs all have financial
10 components such as O&M expense control, managing capital expenditures and
11 achieving our net income targets overall, which, if achieved, lower the revenue
12 requirements to customers. All three of these areas work in concert – Satisfied
13 Employees looking out for the safety of themselves and the public and serving
14 the needs and expectations of Satisfied Customers, and doing so in a financially
15 responsible way.

16 **17. Q: Please summarize how executive and non-executive incentive compensation**
17 **plans benefit the customer.**

18 **A:** As I have previously stated, there are many ways that these plans benefit
19 the customer, including:

20 1. They motivate employees to another level of engagement that translates to
21 additional discretionary effort of going above and beyond in order to serve our
22 customers better. These plans send a clear message to employees as to what the
23 Company believes is important to accomplish as team members working
24 together. I feel these plans positively impact safety which leads to greater

1 efficiency, productivity, higher reliability and customer satisfaction. The cost
2 focus of the incentive program is also designed to reduce the cost of service.

3 2. They save money both directly and indirectly – Savings in terms of
4 increased productivity, reliability, and safety are directly passed on to the
5 customers in future ratemaking.

6 3. They reinforce a team oriented, participative culture – The Company has
7 established values regarding teamwork and valuing the contributions of all
8 employees. Incentives help to reinforce these behaviors, and in so doing benefit
9 customers.

10 4. Finally, incentives as a key component of total compensation allow the
11 Company to compete in the marketplace to hire and retain the best talent.
12 Having the best talent working for our business provides ongoing value to our
13 customers, value that continues to grow over time.

14 **18. Q: Does this conclude your testimony?**

15 **A:** Yes, it does.