

# Kentucky Public Service Commission Vice Chairman

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## Fair, Just and Reasonable / Accountability

As everyone knows, the Kentucky Public Service Commission is statutorily charged with the responsibility of ensuring that utility rates under its jurisdiction are fair, just and reasonable - both for the consumer and the utilities. This Commission takes that responsibility very seriously and acts accordingly.

There have been several large rate cases filed over the past year or so in which PSC staff spent an extensive amount of time reviewing operating and maintenance costs to determine their reasonableness. These costs are thoroughly evaluated and justified based on their appropriateness and reasonability in order to determine fairness.

Although a great deal of time could be spent speaking about O&M costs in general, I will particularly focus on salary and benefits, since the Commission's attention to these costs seems to be causing some industry concern.

As Commissioners we realize that any perceived position change from prior Commissions' practices, especially regarding cost justification for rate base determination, could be unsettling. It has become apparent to us that there is not only concern, but a certain level of misunderstanding, as to how the Commission is evaluating salary and benefit programs. And a great deal of that misunderstanding is probably due to our negligence in providing guidance. I'll attempt to clarify the Commission's position and what standard is being applied in determining what is fair, just, and reasonable with regard to salary and benefits.

As used in this discussion, salary and benefits includes all compensation programs, both from the Kentucky-based operations and allocated overheads from parent companies. They include:

Salaries

Wages - both non-negotiated and negotiated

Incentive compensation

Healthcare insurance

Dental insurance

Vision insurance

Life insurance

Disability insurance – both long and short term

Retirement savings plans with company contributions

Pensions

Post-employment benefits

While this list may not be all-inclusive, the magnitude of its cost materiality cannot be diminished. For example, investor owned utilities' salary and benefit costs represent approximately 1 in every 7 O&M dollars spent, so it should come as no surprise that the Commission is examining them with the same fair, just, and reasonableness standard as any other cost.

I'll give a quick rundown of the Commission's policy by salary and benefit cost category.

1. Salary and non-negotiated wages – Salaries should always be market-competitive as supported by survey benchmarks that include both other utilities and general business. Local, state and national data are always useful and encouraged. Annual salary increases should be performance-based, documented and supported by policy.
2. Negotiated wages – This Commission has no interest in renegotiating or dictating the terms of any labor contract. However, contracts with annual wage increases that appear to be excessive will be questioned and the applicant will be required to provide support showing them to be reasonable.

3. Incentive compensation – This type of compensation will always be more heavily scrutinized for necessity and reasonableness and will need to have a logical basis supported by performance goals for determining distributions.

4. Healthcare and Dental Insurance – The Commission’s position is that for rates to be fair, just, and reasonable - both to the ratepayers and the utility - the utility’s employees should reasonably participate in the cost of their health and dental insurance premiums.

Essentially, utility employee benefits need to be market competitive as measured against not only other utilities but other business sectors and public employees. Keeping that goal in mind, the following data are pertinent.

According to a Fortune article published in March 2016, only 9% of all companies pay 100% of their employees’ healthcare costs, and that percentage continues to decline.

The Henry J. Kaiser Family Foundation 2015 Employer Health Benefits Survey states that “Employers generally require that workers make a contribution towards the cost of the premium. Covered workers contribute on average 18% of the premium for single coverage and 29% of the premium for family coverage, the same percentages as 2014 and statistically similar to those reported in 2010. Workers in small firms contribute a lower average percentage for single coverage compared to workers in large firms (15% vs. 19%), but they contribute a higher average percentage for family coverage (36% vs. 26%). Workers in firms with a higher percentage of lower-wage workers (at least 35% of workers earn \$23,000 a year or less) contribute higher percentages of the premium for family coverage (41% vs. 28%) than workers in firms with a smaller share of lower-wage workers.”

However, there are difficulties in trying to compare healthcare insurance plans company-to-company or even industry-to-industry, because of the differences in coverage levels, deductibles, co-pays and prescription reimbursements.

Keeping this in mind, the key word from the Commission’s perspective is reasonable. Absent any Company-required employee participation in the cost of their healthcare (the company pays 100% of the premium), the Commission has applied a consistent standard utilizing the Bureau of Labor report for all workers in private industry, which, on a statistically sound basis, shows average single and family healthcare coverage

employee cost participation of 21% and 32%, respectively, as a reduction to allowable recoverable costs.

The Commission has been questioned as to why it doesn't utilize the statistical percentages for "Service-providing industries – utility category" instead of the "all workers" category. The reason is obvious: if all utilities offer the same program benefits the comparative percentages will be skewed for that category.

The average dental premium employee cost participation is 60%, as reported by the 2015 Willis Benefits Benchmarking Survey for all employers, and the Commission has applied the same ratemaking philosophy to this category as healthcare.

I will emphasize this point - if the employee percent cost participation is not exactly at the standard percentage levels, but the company does require employee cost participation at a reasonable level, the Commission will not adjust those costs. However, the further the actual percentage is below the standard statistical average percent participation, the greater the probability that the Commission could make an adjustment.

5. Vision and Life Insurances – The Commission has not attached as much significance to these coverages as health and dental cost participation because they are normally not material to total costs and provide a benefit that the utilities can utilize to attract and retain employees. However, utilities need to be prudent in controlling all costs and, as evidenced in a recent rate case, even these types of costs can become excessive. We found that although the IRS ceiling for company paid non-taxable life insurance is \$50,000, the company was offering as much as five times that amount. That would be considered excessive.

6. Pensions – the Defined Dollar Benefit pension plan is the most generous and expensive of retirement plans, which probably accounts for the statistic reported by the advisory firm Willis Towers Watson which states that "between 1998 and 2015, the percentage of employers still offering a traditional defined benefit pension plan to newly hired employees fell from about 50 percent to 5 percent."

401k savings or similar plans are now the prevailing standard retirement plan, as they are much less costly and funding is predictable. The Commission's policy regarding pension plan costs is that they are necessary for the wellbeing of employees, and pension benefit costs have not been adjusted for any plans, regardless of type, except under the following condition:

If a utility with a Defined Dollar Benefit pension plan permits participants to continue to earn benefits through a grandfathered clause, rather than locking and freezing the plan, and simultaneously permits those employees to contribute to a 401k or similar plan in which the company then matches some or all of the employee's contribution, those are duplicative benefits and the Commission will adjust those costs out of the rate base. Many ratepayers have no pension plan at all, and permitting utility employees to participate in multiple pension plans simultaneously is not practicable and is certainly not fair, just or reasonable.

7. Post Retirement Employee Benefits – only 23% of all companies offer retiree health plans, down 66% from 1988, according to the Henry J. Kaiser Family Foundation 2015 Employer Health Benefits Survey. The Commission has thus far elected not to apply any statistical standard to adjust these benefits.

From a personal perspective, I'm concerned that the utility industry in general, regardless of the entity's financial viability, seems to have a philosophy that health, dental and many other benefit programs should be completely or majority funded by the company; that somehow all employees, regardless of their skill level or occupation, are so valuable as to be irreplaceable.

Utilities often support their position by providing the Commission with utility industry-only comparative data indicating that benefits levels being offered are the market standard, when in reality they are highly skewed industry data.

The Commission accepts the premise that the utility industry employs individuals in dangerous occupations. However, many industries are inherently dangerous from an operations standpoint. Salaries of employees in those industries, as well as salaries of all utility employees, should be market based.

We've heard that utility employees are irreplaceable and that without the benefit level being offered many employees would be lost to the competition. Yet in every case that the PSC has heard over the past year, employee turnover ratios have been low to non-existent. Employee turnover has not been an issue.

Would utility management be so inclined to pay what is in effect an employee stability insurance premium if the costs were to be borne not by the ratepayers, but instead were funded by the shareholders out of their profits?