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I. Introduction

1 **Q. Please state your name and position with PGE.**

2 A. My name is Arleen Barnett. My position is Vice President, Administration. My
3 responsibilities include establishing compensation policy and employee policies, improving
4 the work environment, overseeing safety and health programs, employee relations,
5 managing employee development, and overseeing Business Continuity and Security. My
6 qualifications are provided at the end of this testimony.

7 My name is Joyce Bell. My position is Director of Compensation and Benefits in the
8 Human Resources Department. My qualifications are also provided at the end of this
9 testimony.

10 **Q. What is the purpose of your testimony?**

11 A. Our testimony presents and explains PGE's compensation costs for the 2011 test year and
12 describes significant changes to our compensation policies and plans since 2008. Total
13 compensation costs include base wages and salaries, incentive pay, and employee benefits.
14 We also present and explain PGE's proposal to establish an adjustment mechanism to
15 recover pension expense and financing costs on incremental cash contributions to the
16 pension trust. We then discuss PGE's changing pension investment strategy, which will
17 limit expense and cash contribution volatility.

18 **Q. What are PGE's expected total compensation costs in 2011?**

19 A. PGE forecasts approximately \$278 million in total compensation costs for 2011, with the
20 increase relative to 2008 driven by the costs of benefits, particularly health related. Table 1
21 summarizes the costs.

Table 1
Estimated Total Compensation Costs (\$Millions)

Component	2008 Actuals	2011 Test Year
Wages & Salaries	191.2	202.9
Incentives	16.1	6.1
Benefits	49.9	69.0
Total Compensation	257.1	278.0

1 The increase in wages and salaries since 2008 is primarily due to market-driven wage and
 2 salary adjustments (\$17.8 million), but is partially offset by FTE reductions (\$6.1 million)
 3 which are primarily AMI-driven. Test year incentive costs are \$6.1 million reflecting
 4 application of the Commission’s decision in UE 197 to our 2011 incentive costs. Benefits
 5 reflect continued cost increases in medical premiums, an increased cost associated with the
 6 new defined contribution plan due to the closure of PGE’s pension plan in 2009 and
 7 renegotiated benefits per the 2009 bargaining agreement.

8 **Q. What is PGE’s total compensation philosophy?**

9 A. PGE’s philosophy is to provide compensation sufficient to attract and retain employees
 10 necessary to provide safe and reliable electric service. At the same time, PGE actively
 11 controls costs by targeting our compensation program attributes and costs to reflect market
 12 median conditions.

13 **Q. What major challenges does PGE face by following its compensation philosophy?**

14 A. PGE faces three major challenges: 1) recruiting, 2) rising health care costs, and 3) an
 15 experienced but aging workforce, which will result in PGE facing significant numbers of
 16 retirements.

17 **Q. Please describe PGE’s approach to the first challenge – recruiting.**

18 A. PGE faces significant challenges in recruiting and hiring that are common to the industry.
 19 In 2009, PGE’s major recruiting challenges were in the areas of Finance, Tax, Legal and

1 Transmission. Despite the current economic environment, the market is very competitive
2 for skilled professionals in those fields and those recruited employees tend to have already
3 been gainfully employed and, in most cases, with long tenure. To fill some of the positions,
4 PGE enlisted the services of contingency-based search firms and offered wages in excess of
5 the mid-point of our pay-guides, in addition to other increased benefits. We expect similar
6 recruiting challenges to continue, and as the economy recovers, we foresee specific
7 challenges in recruiting such skilled positions such as Wireman, Metermen, and Information
8 Technology (IT) Analysts.

9 **Q. How does PGE combat the second challenge – rising health care costs?**

10 A. PGE aggressively negotiates with vendors for favorable terms for provider contracts and
11 outside services. PGE also negotiates and implements plan elements that offer cost
12 efficiencies (one example is a value-based pharmacy plan). PGE performs internal studies
13 to understand which health issues are contributing the most costs. PGE has developed
14 targeted wellness programs designed to reduce long-term costs by lowering employee risk
15 factors. Finally, as health plan costs rise, employees share the increased burden, aligning
16 their interests with PGE's to minimize costs.

17 **Q. Please describe how PGE is planning to meet the third challenge – an aging workforce.**

18 A. Approximately 40% of PGE's workforce will be eligible to retire (at least 55 years of age
19 and five years of service) by the end of 2011. The historical retirement age of a PGE
20 employee has been 60 years. However, due to the effects of the economic downturn, our
21 annual number of employees retiring remains low despite the increasing number of workers
22 eligible to retire. Meanwhile, we continue to recruit and train employees to fill vacancies in
23 critical positions that have a high impact on the organization, have long learning curves, and

1 are hard to fill. Examples of these are specialized utility positions such as Transmission and
2 Reliability Specialists and Engineers, Standards and Electrical Engineers, senior-level
3 skilled crafts persons such as line and substation technicians, and senior-level utility analysts
4 and specialists. In addition, as the population of retirement-eligible employees increases, we
5 will continue our workforce development and outreach efforts in K-12 and post-secondary
6 education institutions to develop a future pool of workers.

7 **Q. Have recent economic challenges had an impact on PGE's compensation strategy?**

8 A. Yes. The current economic downturn has presented challenges for many companies. PGE
9 has made difficult decisions regarding compensation, including reducing merit increases,
10 restructuring incentives, and reducing other benefits. These reductions result in PGE's total
11 compensation currently being below market, making recruiting efforts more difficult, and
12 negatively affecting employee morale since there have been no corresponding reductions in
13 workload.

14 **Q. Are these reductions sustainable?**

15 A. No, not in the long run. These reductions were necessary one-time events given the
16 economic environment and its effect on PGE's financial position. It is important for PGE to
17 remain competitive as the economy improves, unemployment declines, and more jobs
18 become available. Employee morale is also an important factor in keeping service and
19 productivity levels high.

II. FTEs and Wages & Salaries

1 **Q. How does PGE calculate its 2011 total wage and salary revenue requirement?**

2 A. Total wages and salaries are a function of the number of full-time equivalents (FTEs) and
 3 the market-based pay structure.

4 **Q. Please describe how PGE determines the number of FTEs required for the test year.**

5 A. As part of the annual budgeting process, managers determine the number of labor hours in
 6 each position type that are required to accomplish their departments' work. PGE groups
 7 positions into 17 categories for exempt employees (excluding officers), 14 categories for
 8 non-exempt employees, and one category for union employees. PGE then converts the total
 9 labor hours into FTEs by dividing total labor hours by the number of work hours during the
 10 year. For example, an employee hired mid-year would be budgeted as one-half (or 0.5)
 11 FTE. As we discuss later, we then made an adjustment for normal vacancies that occur
 12 throughout the year. For historical periods, FTEs are reflective of the actual number of hours
 13 worked divided by the number of work hours during that year. Table 2 provides PGE's
 14 actual total FTEs (excluding overtime) for 2008 and forecast for 2011.

**Table 2
 Full-Time Equivalents**

PGE FTEs (straight time, unless indicated)	2008 Actuals	2011 Test Year
Administrative and General	622.7	632.7
Customer Service/Accounts	589.9	472.2
Generation	435.8	455.7
Transmission & Distribution	963.5	968.7
Total FTEs	2,611.9	2,529.3

15 **Q. Why do FTEs decrease from 2008 to 2011?**

16 A. FTEs decrease by 82.7 from 2008 to 2011 due to a significant workforce reduction
 17 associated with Advanced Metering Infrastructure, which more than offsets increases in

1 other areas. Below is a summary of the primary FTE changes and references to testimony
2 where they are described in more detail.

- 3 • + 10.0 A&G/IT (PGE Exhibits 600 and 1000)
- 4 • - 117.7 Customer Service, including the impact of Advanced Metering Infrastructure
5 (PGE Exhibits 300 and 900)
- 6 • + 19.9 Generation (PGE Exhibit 700)
- 7 • + 5.2 Transmission and Distribution (PGE Exhibit 800)

8 Adjusting for AMI, 2011 represents an increase of 33.5 FTE, or less than 0.5% annual
9 growth, since 2008. This annual growth rate is well below the 1.45% annual growth rate
10 approved by the Commission in UE 197 (see Order No. 08-601, pgs. 10-11), and is less than
11 the annual rate of growth in customers since 2008.

12 **Q. Please describe how PGE determines its pay structure.**

13 A. In keeping with PGE's total compensation philosophy, PGE routinely compares its wages
14 and salaries to the relevant markets. This practice ensures that our current and prospective
15 employees are fairly compensated while costs are controlled. In 2009, we compared our
16 hourly non-union and salaried non-officer positions with the market. The study showed that
17 PGE's wage and salary structure is highly correlated with the market.

18 PGE reviews market surveys and Bureau of Labor Statistics and takes into account
19 employee merit increases, if appropriate, to estimate the wage escalation factor used to
20 develop the 2011 test year. PGE forecasts a 2.01% annual increase in overall wages and
21 salaries since 2008. Combining required FTEs with wage and salary increases determines
22 PGE's 2011 revenue requirement. Table 3 summarizes total wage and salary costs for 2008
23 and 2011.

Table 3
Total Wages & Salaries (\$000)

PGE Wages & Salaries (straight time)	2008 Actuals	2011 Test Year
Administrative and General	\$52,852	\$57,221
Customer Accounts	25,843	21,309
Customer Service	7,823	8,567
Generation	32,957	38,419
Transmission & Distribution	70,833	76,637
Trojan Decommissioning	859	753
Total Wages & Salaries	\$191,167	\$202,906

1 **Q. Has PGE made any adjustments to arrive at its 2011 FTEs and wages and salaries**
 2 **figures?**

3 A. Yes. To account for vacancies and/or unfilled positions, PGE has removed approximately
 4 \$8.0 million from its base budget wages and salaries, which translates into an FTE reduction
 5 of approximately 99. The figures in Table 2 and Table 3 are net of these reductions.

6 **Q. Did PGE recently renegotiate its contract with the Union including changes in**
 7 **compensation and benefits?**

8 A. Yes. In 2009, PGE completed negotiations with the Union and initiated a new Collective
 9 Bargaining Agreement (CBA) that is effective beginning March 2009 through February
 10 2012. The CBA establishes a level of compensation for bargaining employees including
 11 wages, medical and retirement benefits which are competitive and approximate the 50th
 12 percentile of the market.

13 **Q. What portion of PGE’s wages and salaries does the Union represent?**

14 A. The Union represents approximately 30% of PGE’s wages and salaries.

15 **Q. Did PGE freeze wages in 2009?**

16 A. Yes. Given the financial pressures on PGE and its customers, PGE decided to place a hold
 17 on exempt employees’ salary increases (including officers), other than increases for certain
 18 high performing employees who were paid significantly below market (excluding officers).

1 **Q. Does PGE intend to continue to freeze wages in 2010 and/or 2011?**

2 A. No. As a result of the wage freeze in 2009, employees' salaries are now below the market
3 reference point. This reduces PGE's ability to retain these employees and makes attracting
4 new employees more challenging, as they could do the same job elsewhere for higher
5 wages. Turnover in 2009 was down slightly, which reflects the impact of economic
6 conditions on retirements and job prospects. However, maintaining or expanding this deficit
7 by freezing wages again would begin to severely hamper PGE's ability to attract and retain
8 qualified employees as the economy recovers and job opportunities expand.

III. Incentives

1 **Q. What is PGE’s strategy for incentive compensation?**

2 A. As with wages and salaries, PGE’s strategy is to provide incentive pay that attracts, retains,
 3 and motivates employees. PGE monitors the employment market and acquires information
 4 regarding incentive compensation program design practices. Even though it is a small part
 5 of PGE’s total compensation, incentive pay allows PGE to remain competitive in the labor
 6 market while encouraging employee performance and productivity. PGE’s incentive
 7 programs align employee goals with shared customer and company goals to reduce power
 8 costs, improve customer satisfaction, and preserve PGE’s financial stability.

9 **Q. What fraction of PGE’s total compensation are incentives?**

10 A. Incentive pay was approximately 6.3% of PGE’s 2008 total compensation, but is only 2.2%
 11 of PGE’s 2011 total compensation. Table 4 provides detailed actuals for 2008 and forecast
 12 for 2011.

**Table 4
 Total Incentives (\$000)**

Incentives Component	2008 Actuals	2011 Test Year
Performance Incentive Compensation	5,232	3,330
Annual Cash Incentive	7,281	2,026
Stock (long-term incentive plan)	2,177	647
Notables and Miscellaneous	1,401	135
Total Incentives	16,091	6,138

13 **Q. Have there been any changes to PGE’s incentive plans?**

14 A. Yes. PGE changed both the Corporate Incentive Program (CIP) and the Annual Cash
 15 Incentive (ACI) plans for employees to further align goals with customer interests. The
 16 Performance Incentive Compensation (PIC) plan replaced the CIP. The structure of the two
 17 plans now have a higher performance bar, have a greater emphasis on operational efficiency

1 and process improvements that add value to our customers and shareholders, and are
2 described in more detail below.

3 **Q. Why was this change necessary?**

4 A. It is important that PGE's incentive plans directly support PGE's strategic direction, our
5 commitment to our core principles, continuous improvement, and performance
6 advancement. Improvements in efficiency and process benefit both customers and
7 shareholders. PGE has made the goals of the new incentive plans more difficult to achieve,
8 encouraging our employees to improve their daily processes and PGE's overall efficiency.
9 Customers benefit from lower expenses and a more efficient company, while the expected
10 higher net income helps PGE to maintain a competitive stock price and access to capital.
11 Copies of the new incentive plans are included in our work papers.

12 **Q. Please explain how the PIC plan aligns employee performance measures with customer
13 interests.**

14 A. PGE aligned its PIC plan with customer interests by basing the incentive pool on two
15 customer-focused goals:

- 16 • Individual or Team Performance: These individually determined goals encourage
17 growth, development, and alignment with corporate operational goals (e.g.,
18 efficiency, operational standards). Actual award amounts will be based on
19 employees' incentive targets and their performance achieving Scorecard results.
- 20 • Financial Performance: Financial strength can reduce customer rates through
21 lower borrowing costs and, thus, lower cost of capital. This portion of the plan
22 will only be funded if financial goals are met.

1 **Q. Did the incentive plans for Biglow, Port Westward, and Coyote Springs also change?**

2 A. Yes. They have been updated since 2007 and continue to motivate employees to pursue
3 efficiencies and a high level of operations at the respective plants.

4 **Q. Please explain how the ACI plan aligns employee performance measures with customer**
5 **interests.**

6 A. PGE aligned its ACI plan with customer interests by basing the incentive payouts on PGE's
7 success in achieving four customer-focused goals described below. The first three goals are
8 weighted together and then factored with the final goal of Net Income.

9 • Customer Satisfaction: This goal measures the overall satisfaction of PGE's retail
10 customer groups using results from 1) the average quarterly percent rating of the
11 Market Strategies International ("MSI") study for residential customers, 2) the
12 average semi-annual percent rating of the MSI study for business customers, and
13 3) the annual results from the TQS Research, Inc. National Utility Benchmark of
14 Service to Large Key Accounts. The results of the three measures are weighted
15 based on overall revenue generated for each retail customer group, respectively.

16 • System Reliability: This goal is measured using annual results of the company's
17 1) System Average Interruption Duration Index (SAIDI), the average outage
18 duration for each customer served, 2) System Average Interruption Frequency
19 Index (SAIFI), the average number of interruptions that a customer would
20 experience, and 3) Momentary Average Interruption Frequency Index (MAIFI),
21 average number of momentary interruptions that a customer would experience.
22 Both SAIFI and MAIFI goals must be met at their targets to trigger a payout for
23 SAIDI.

- 1 • Generation Availability: General plant availability influences power costs. In the
2 long-term, if we further reduce forced outage rates, power costs should also
3 decline.
- 4 • Net Income: As mentioned above, financial strength can reduce customer rates
5 through lower borrowing costs and, thus, a lower cost of capital.

6 Weighting for the first three categories and the potential percentage of payout vary by
7 position level and individual.

8 **Q. Please describe PGE’s long-term incentive program.**

9 A. PGE initiated its stock incentive plan in 2006 and it reflects market practice; many publicly
10 traded companies provide stock incentives to promote performance and retention of
11 directors, officers, and key employees. PGE’s stock incentive awards are earned and paid
12 out after several years. The Commission approved this stock issuance and accurately
13 summarized the goals of the plan: “the Plan is part of the Company’s overall compensation
14 package and is intended to provide incentives to attract, retain, and motivate officers,
15 directors, and key employees of the Company” (OPUC Order No. 06-356, p.1). PGE
16 forecasts approximately \$0.7 million for the 2011 total stock incentive expense.

17 **Q. Does PGE have other programs that reward employees’ exceptional performance?**

18 A. Yes. Notable Achievement Awards (Notables) and miscellaneous awards are given to
19 employees on a case-by-case basis for exceptional performance. Notables are promptly
20 distributed to recognize employees’ outstanding work on a specific project or task. PGE’s
21 2011 forecast for Notables is \$125,000. PGE forecasts \$10,100 for miscellaneous awards in
22 2011 that are also available for managers to distribute on a case-by-case basis when
23 performance is extraordinary, but does not fit within the Notable framework.

1 At times, and in specific situations, we have also employed other types of incentives
2 such as signing bonuses and retention payments to obtain difficult-to-locate talent, in periods
3 of critical skill competition, to ensure the completion of important tasks, or to hold
4 employees in cases of future layoffs (e.g., Trojan decommissioning). However, these types
5 of incentives are not included in the 2011 test year.

6 **Q. Did you exclude a portion of incentive plan costs from this case?**

7 A. Yes, we incorporated an adjustment to remove 100% of the cost of officer incentives (ACI
8 and stock incentives) and 50% of the cost of incentives for all other employees. This
9 adjustment is reflected in Table 4.

10 **Q. Why did PGE make this adjustment?**

11 A. We are making this adjustment in this rate case to mitigate the overall size of the rate
12 increase. PGE has worked diligently to design incentive plans that fully benefit customers,
13 provide reasonable incentive to both attract and retain qualified individuals, and to achieve
14 corporate goals. This minimizes turnover, increases efficiency, and produces positive
15 financial results – all goals that directly, positively impact PGE’s costs to customers. While
16 we have made this adjustment in this filing, we still believe that these costs are appropriate
17 to be included in customer prices in the future.

IV. Benefits

Q. What is PGE’s benefit compensation strategy?

A. PGE strives to maintain a benefits package that meets our employees’ needs and balances the features and costs among programs, employee groups, and PGE and the market. As with the other two compensation components (wages/salaries and incentives), PGE compares our benefits programs to the market and targets prevailing market attributes. PGE also uses market information to create innovative program designs to provide greater employee choice and improve our ability to control costs. As a result, we believe that our total compensation package is sufficient to attract and retain quality employees.

Q. What components comprise PGE’s total benefits?

A. There are four major components: health and wellness, post-retirement, disability and life insurance, and miscellaneous benefits. These components are typical parts of our competitor companies’ offerings. As shown in Table 5 below, PGE’s total benefits costs are expected to increase 11.5% annually from 2008, driven primarily by health and pension costs. We project 2011 employee benefit costs of \$69.0 million.

**Table 5
 Total Benefits (\$000)**

Benefits Compensation Component	2008 Actuals	2011 Test Year
Health and Wellness	29,806	41,030
Disability and Life Insurance	1,934	3,134
Post-Retirement	16,909	23,712
Miscellaneous Benefits	571	731
Benefits Administration	635	413
Total Benefits	49,853	69,019

Q. Have there been any changes to PGE’s retirement plans?

A. Yes. Beginning February 1, 2009, PGE closed its pension plan to new participants. Employees who are hired after February 1 participate in the new defined contribution plan.

1 This new plan allows for a dollar-for-dollar employer match for the first 5% that a
2 participant contributes to his 401(k) plan. The company will also contribute an additional
3 5%. Thus, an employee could potentially see as much as 10% contributed to his 401(k) by
4 PGE each year, if they contribute at least 5% on their own. The closure of the pension plan
5 did not impact employees at the Coyote or Port Westward facilities, whose continuing
6 participation in the pension plan is subject to negotiation.

7 **Q. Why did PGE make this change?**

8 A. FAS 158 requires PGE to include the market value of the pension plan assets on its balance
9 sheet, which introduces significant volatility to PGE's financials. The Pension Protection
10 Act also increases the volatility of pension funding and generates new funding requirements
11 that increase net income volatility. (The direct implications of these changes are discussed
12 further in Section V below.) As a result, we asked Hewitt Associates (Hewitt), a Human
13 Resources consulting firm, to prepare a study on retirement plan redesign. After review, we
14 decided to close the pension plan and shift new employees to the new defined contribution
15 plan. The new plan is aligned with the shift from defined benefit to defined contribution
16 plans that is occurring in today's market, in local utilities and other industries.

17 **Q. How is PGE trying to mitigate increases in benefit costs?**

18 A. PGE works hard to keep benefit costs down through programs that encourage a healthy
19 workforce, modifying benefits plan structures to track market practice, and negotiating for
20 favorable contract terms. For example, we implemented an innovative value-based
21 pharmacy design with Providence in 2009 that reduced premiums and reimburses
22 participants more for chronic conditions, which are one of the major drivers of healthcare
23 costs. The goal is ongoing and thorough treatment, which leads to lower costs in critical

1 care or emergencies. The annual premium savings associated with value-based pharmacy
2 are approximately \$0.2 million. As chronic conditions are brought under control, PGE's
3 future medical premiums will be lower than they would be without such a program. PGE
4 has also worked to reduce outside fees by streamlining the quantity of analyses that our
5 consultants perform and by renegotiating vendor contracts. Additionally, when health care
6 premiums do rise, PGE shares the cost increases with employees.

7 PGE also adjusts program features to help control costs. As discussed above, PGE
8 closed its pension plan and transitioned to a new defined contribution plan, which minimizes
9 the pension plan's long-term risk to customers by reducing their exposure to market
10 volatility. We also introduced the value-based pharmacy (mentioned above). For PGE's
11 union employees, we were able to change their plan from a Base Major Medical plan to a
12 Comprehensive Preferred Provider plan during negotiations in 2009, which utilizes
13 preventative medicine and cost sharing to help contain costs in the future.

14 Finally, PGE invests in internal health and wellness programs to help identify and lower
15 health risk factors that reduce long-term medical issues and reduce plan costs. We provide
16 tools for persons identified as high risk during our health screenings to lower their medical
17 risks (e.g., diabetes, heart disease, high cholesterol, high blood pressure, etc.). PGE's
18 medical vendors provide and encourage participation in wellness programs and disease
19 management programs for our employees. These programs help reduce major medical
20 events which impact our medical premiums. Increased awareness and case management
21 results in fewer medical events and claims, which results in lower future premiums.

22 **Q. Medical and dental benefits costs increased approximately \$11 million from 2008.**

23 **What causes the increase in these costs?**

1 A. Nationally, medical and dental costs continue to rise each year. PGE strives to keep those
 2 increases as low as possible. Premiums are the main drivers for the increased cost in PGE’s
 3 medical and dental benefits. Medical and dental plan premium percent increases for non-
 4 bargaining employees are detailed in Table 6 below.

Table 6
Non-bargaining Medical & Dental Premium (% change)

	2008	2009	2010	2011 ⁽²⁾
Kaiser Medical	10.40%	3.90%	11.10%	8.60%
Kaiser Dental	2.40%	3.20%	5.70%	8.60%
Providence ⁽¹⁾	6.5-12.40%	6.9-12.20%	2.7-3.60%	8.60%
MetLife Dental	-2.00%	1.70%	4.80%	8.60%

(1) Providence has 4 different plans. The changes above are ranges amongst the 4 plans.

(2) 2011 forecast provided by Mercer

5 Health care premiums for the main bargaining unit are a negotiated benefit and
 6 managed by a Taft-Hartley Trust. We forecast that bargaining employee medical and dental
 7 plan costs will increase approximately 12% annually based on a semi-annual survey of local
 8 insurance companies’ annual claims cost trend rates performed by Mercer. These rates are
 9 used by the insurance companies to project their insured renewal rates.

10 **Q. What Health and Wellness expenses are included in the 2011 test year?**

11 A. PGE forecasts approximately \$0.5 million for health and wellness costs in 2011. PGE
 12 strives for a healthy workforce, and its wellness programs, which are in line with the Oregon
 13 Governor’s wellness initiative in 2008¹, provide early detection of risk factors, intervention
 14 and management of health issues. These programs promote healthier lifestyles, which
 15 contribute to lower medical premiums, increased morale, team building and productivity.
 16 Such programs include Energy for Life and the AfterHours Program. Energy for Life health
 17 programs include biometric testing, health risk appraisals, professional health coaching,
 18 obesity management, health club reimbursements and disease prevention. The AfterHours

¹ http://governor.oregon.gov/Gov/P2008/press_103108.shtml

1 program provides partial reimbursements to employees who engage in programs that
2 promote social engagement and healthy lifestyles. Also included is occupational health
3 services, which provides flu shots, health screening, and case management.

4 **Q. PGE’s benefits programs use “flex dollars.” How do flex dollars work?**

5 A. PGE allocates flex dollars to eligible non-bargaining employees each pay period.
6 Employees use these flex dollars to help pay for medical, dental, vision, employee life
7 insurance and accidental death and dismemberment (AD&D) premiums.

8 **Q. How do PGE’s health plan costs compare to market benchmarks?**

9 A. PGE’s costs are at or below market benchmarks. Towers Watson (formerly Towers Perrin)
10 reports the results of a survey of health care plan costs incurred by various employers and
11 PGE’s reported non-bargaining medical care costs in the 2009 study are slightly below that
12 of the Electric/Utilities Industry. An analysis of the composition of participants (age,
13 gender, family size, etc.) in PGE’s plans was included as part of this study in order to create
14 a benchmark incorporating the survey data, adjusted to reflect the costs of a population
15 comparable to PGE’s. PGE’s costs per non-bargaining employee fall 6% below the cost per
16 employee of this benchmark.

17 **Q. What is PGE’s targeted cost-sharing ratio?**

18 A. PGE targets an overall cost-sharing ratio of 85% company and 15% employee for non-union
19 medical, dental and vision premiums; this ratio is reflected in the quantity of flex dollars
20 employees receive. Employees then pay the remainder of the costs. Per the 2009 Energy
21 Services BENVAL Study, a comparison of benefit values among peer utilities with similar
22 revenues, also prepared by Towers Watson, PGE is at the industry average for its share of
23 overall benefit program costs.

1 **Q. Please explain PGE’s 2011 disability and life insurance benefit forecast of \$3.1 million.**

2 A. PGE’s disability and life insurance benefits are comprised of union short-term disability
3 insurance, long-term disability insurance, and retiree group life insurance for all employees.

4 PGE forecasts union short-term disability insurance costs of approximately \$457,000 in
5 2011. This is relatively flat compared to 2008, representing a decrease of less than 1%.
6 PGE successfully negotiated a competitive union short-term disability contract that renews
7 annually. Costs for 2010 and 2011 appropriately reflect current claims history. PGE’s non-
8 union short-term disability expense is included as a payroll labor loading, and is not
9 included in the short-term disability forecast.

10 PGE forecasts long-term disability costs for bargaining and non-bargaining employees
11 to be approximately \$1.6 million in 2011. PGE relies on a forecast by Towers Watson
12 (Towers), an outside actuary, to budget for these expenses. Actual long-term disability
13 costs fluctuate from year-to-year. The actuarial forecasts are driven by factors such as the
14 discount rate applied, the health care trend assumptions used, the number of participants,
15 and the demographics of the participant population. The expense in a given year is
16 calculated as the difference between the ending and beginning liabilities, plus the benefits
17 actually paid by PGE in that year. PGE pays 85% of the health care benefits for non-union
18 employees and 90% for union employees on long-term disability.

19 PGE forecasts retiree group life insurance costs to be approximately \$1.04 million in
20 2011. The discount rate used by Towers is based on a high quality bond benchmark and was
21 reduced in 2009 from 6.75% to 6.25%. This change results in increased annual
22 contributions because investments are expected to grow at a slower rate. For bargaining

1 employees, PGE pays for a level of coverage for life insurance for retiree members. Active
2 union members pay for their own life insurance.

3 **Q. What is included in PGE's Post-Retirement benefits costs?**

4 A. PGE classifies the Retirement Savings Plan (RSP) and the PGE Pension Plan as
5 post-retirement benefits. For purposes of this testimony, we also present the Health
6 Reimbursement Account (HRA) as a post-retirement benefit².

7 PGE's RSP costs are based on employee contributions and PGE's match and include an
8 employer contribution for union employees and non-union employees hired after
9 February 1, 2009 not in the defined benefit plan. These costs change with base wage and
10 salary levels and employee participation. Employees represented under the main bargaining
11 contract participate in either PGE's pension program or the RSP but not both. From 2008 to
12 2011, costs associated with the RSP are expected to increase from \$14.6 million to \$16.5
13 million, or approximately 4.1% annually. This increase is primarily a result of a 1%
14 bargained increase to the fixed contribution for the union participants beginning
15 March 3, 2010 (per the 2009 bargaining agreement) and an increase in contributions for new
16 non-union employees in the new RSP plan design discussed above. We discuss pension
17 obligations in Section V below.

18 PGE forecasts total HRA costs to be approximately \$1.4 million in 2011, which
19 represents a 2% annual reduction since 2008. The HRA provides a post-retirement benefit
20 to cover a portion of health care premium costs for employees who retire from PGE. For
21 non-bargaining employees, only those who retire from PGE will receive any HRA benefit.
22 For these employees, PGE places 0.5% of wages and salaries into a notional account for

² To comply with ERISA accounting guidelines, PGE classifies the HRA as a health and wellness benefit, even though employees do not receive the benefit until after retiring from PGE.

1 retiree HRA benefits. For bargaining employees, the new CBA provides that, beginning
2 March 4, 2009, PGE's contribution of \$0.50 per straight-time hour into the HRA account
3 will be diverted as a contribution into the employees' RSP. This amount will increase to
4 \$1.00 per straight-time hour beginning effective November 2011 in lieu of an additional
5 wage increase.

6 **Q. Why are post-retirement benefits important?**

7 A. Post-retirement benefits support employee recruitment and are an important retention
8 device. Retirement-eligible employees are generally highly productive, and will work until
9 full or close to full pension coverage. The retirement benefits encourage retention and help
10 ensure knowledge transfers between retiring and new employees.

11 **Q. What is PGE's 2011 cost for miscellaneous employee benefits?**

12 A. PGE forecasts 2011 costs for miscellaneous benefits to be approximately \$0.7 million.
13 Miscellaneous benefits are additional tools that PGE uses to attract and retain employees.
14 These tools help balance employer-provided benefits with the changing realities of our
15 demographics and market position. PGE's miscellaneous benefits costs are primarily
16 educational assistance and Service Awards.

- 17 • Education Assistance: \$453,340 – This program reimburses employees for
18 education that enhances learning and development. It can be applied to classes
19 that lead to a certification or undergraduate/graduate degree and classes that
20 enhance technical knowledge. This program increases the availability of qualified
21 employees to fill open positions. Career development is also a prime recruiting
22 tool and source of employee motivation and satisfaction, which also aids
23 retention.

- 1 • Service Awards: \$225,000 – As a retention and morale improvement strategy,
2 PGE honors employees for their years of service at five-year anniversary
3 intervals. PGE has historically been considerably under market in the awards
4 provided.

5 **Q. Why do PGE’s Benefits Administration costs decrease from \$635,000 in 2008 to**
6 **\$413,000 in 2011?**

7 A. PGE has diligently worked to reduce costs and was able to reduce costs for consultants and
8 outside vendors by renegotiating contracts and decreasing the scope of work of consultants.

V. Pension

1 **Q. Please describe PGE’s defined benefit pension plan.**

2 A. PGE sponsors a non-contributory, defined benefit pension plan, of which substantially all
3 participants are current or former PGE employees. As of December 4, 2009, the plan had
4 approximately 4,450 participants, of which approximately 1,850 are active non-union, 700
5 are active union, and 1,900 are retirees. Eligible individuals vest after 5 years of service and
6 accrue benefits based on a number of factors, including years of service and final average
7 earnings. PGE’s pension benefit obligation is expected to continue to increase over the next
8 several years as remaining eligible employees vest.

9 **Q. Has PGE taken any actions to limit its pension benefit obligation?**

10 A. Yes. As discussed previously, effective February 1, 2009, new non-bargaining employees
11 are ineligible for the pension plan. Though the near-term effect is minimal, closing the plan
12 will reduce PGE’s future liability and exposure to market fluctuations. PGE previously
13 closed the plan to new bargaining unit employees effective January 1, 1999. In addition,
14 PGE has not granted a cost of living adjustment for retirees since 1994, limiting the
15 adjustment to only those receiving less than the minimum benefit.

16 **Q. What is the funded status of PGE’s pension plan?**

17 A. PGE must consider two different measures of “funded” status. First, for Financial
18 Accounting Standards (FAS) purposes, PGE’s pension plan was 83% funded as of
19 December 31, 2009. This compares to 81% as of December 31, 2008. Second, for Pension
20 Protection Act (PPA) purposes, PGE’s pension plan was 86% funded as of December 31,
21 2009. This compares to 108% as of December 31, 2008. PGE Exhibit 501 shows the
22 pension’s FAS 87 funded status, discount rate, investment return, benefit payments, and

1 cash contributions between 1998 and December 31, 2009. PGE’s pension plan has been
2 fully funded for most of this period and, as a result, PGE’s customers have borne very little
3 pension cost.

4 **Q. What are PGE’s projections for expense, cash contributions, and the funded status of**
5 **the pension plan for the next five years?**

6 A. PGE’s third-party actuary, Hewitt Associates, estimated PGE’s pension expense and cash
7 contributions for the next five years. Confidential PGE Exhibit 502C contains their
8 estimates as of November 6, 2009.

A. Pension Funding Requirements

9 ***1. Pension Expense***

10 **Q. How is pension expense calculated?**

11 A. Pension expense, more formally known as “FAS 87 net periodic benefit cost,” is comprised
12 of the following components: service cost, interest cost, expected long-term rate of return on
13 assets, amortization of prior service cost, and amortization of net gains or losses.

14 **Q. What assumption does PGE use for its expected long-term rate of return?**

15 A. PGE uses an expected long-term rate of return of 8.50%.

16 **Q. How is PGE’s expected long-term rate of return determined?**

17 A. Based on the pension plan’s asset allocation, an equivalent portfolio invested in passively
18 managed funds is expected to yield a long-term rate of return of 7.95%. To this we add
19 approximately 55 basis points (net of fees) of additional expected return because the plan is
20 invested in actively managed funds.

21 **Q. What assumption does PGE use for its discount rate?**

1 A. PGE uses a discount rate of 6.5%, which is a market-based forecast of rates of return on
2 long-term high quality (AA rated) bonds.

3 **Q. How sensitive are PGE's pension costs to changes in the long-term rate of return and**
4 **the discount rate?**

5 A. A 0.25% increase in the expected long-term rate of return on plan assets would decrease
6 PGE's expected 2011 pension expense by approximately \$1.2 million. A 0.25% reduction
7 in the discount rate would increase PGE's expected 2011 pension expense by \$1.4 million.
8 This sensitivity is exemplified by the plan's 2009 performance where, despite an
9 approximate 26% return on assets, a 100 basis point decline in discount rate outweighs the
10 return - resulting in only a 2% increase in the funded status between 2008 and 2009.

11 **2. Pension Protection Act**

12 **Q. Please summarize the requirements of the Pension Protection Act.**

13 A. Signed into law in August 2006, the PPA creates funding percentage requirements for
14 private industry culminating in a requirement of greater than, or equal to, 100% beginning in
15 2012. In the meantime, funding percentage requirements escalate 2% annually beginning at
16 90% in 2007. The 2011 percentage funding requirement is 98%.

17 **Q. Does the PPA provide funding options?**

18 A. Yes. The PPA provides two options for funding any shortfall: lump-sum or 7-year
19 amortization.

20 • A lump-sum contribution would require PGE to make a cash contribution to raise
21 the value of plan assets to the percentage funding requirement. PGE must make
22 an additional cash contribution in an amount equal to Target Normal Cost less any
23 credit balance (we discuss these concepts below).

- 1 • The 7-year amortization method allows PGE to make a series of smaller cash
2 contributions over the course of 7 years. The contributions are equal to a 7-year
3 amortization of the difference in the value of plan assets less any credit balance
4 and the percentage funding requirement. PGE must also make a cash contribution
5 in an amount equal to Target Normal Cost less any credit balance.

6 **Q. What is Target Normal Cost?**

7 A. Target Normal Cost (TNC) is the present value of benefits accrued during the year. PGE
8 must make a cash contribution equal to TNC unless one of the following criteria is met:

- 9 • The plan is over-funded in an amount greater than or equal to TNC;
10 • PGE has a credit balance in an amount greater than or equal to TNC; or
11 • The combination of a credit balance and over-funding is greater than or equal to
12 TNC.

13 **Q. What is a credit balance?**

14 A. A credit balance is created when PGE makes a contribution to the pension plan when one is
15 not required. PGE made such a contribution in 2005 of \$10 million. Any such contributions
16 are aggregated and adjusted by the plan's earnings rate and can be used to offset future cash
17 contribution requirements.

18 **Q. Does PGE propose using the 7-year amortization funding option?**

19 A. Yes. Using the 7-year amortization option dramatically reduces the size of the contribution
20 made in the test year, limiting the potential impact to customers. The 7-year amortization
21 option also has the benefit that, if PGE's funded status were to meet or exceed the
22 percentage funding requirement in a subsequent year, then future contributions are no longer

1 required. For example, if 4 years into the 7-year amortization PGE's funded status exceeds
2 the 100% requirement, the remaining 3 years of contributions are no longer required.

3 **Q. Does this amortization period differ from that of FAS 87 net periodic benefit cost?**

4 A. Yes. Pension expense smoothes out pension costs over the remaining life of the plan's
5 participants, which is one of the primary reasons cash contributions differ from FAS 87
6 expense.

7 **Q. Does PGE use the same assumptions for discount rate and expected long-term rate of
8 return for pension expense and PPA funding requirements?**

9 A. Yes.

10 **Q. Do the assumptions for calculating FAS expense and PPA cash contributions differ?**

11 A. Yes. There are two primary differences, one on the asset side and one on the liability side of
12 the equation. On the asset side, for FAS purposes, PGE must use the market value of the
13 portfolio at December 31. For PPA purposes, PGE has the flexibility to use the market
14 value of the portfolio at December 31 or to look back and choose a period over which to
15 calculate the average balance.

16 On the liability side, for FAS purposes, PGE must use the discount rate as of
17 December 31. For PPA purposes, PGE has the flexibility to use a month's average or pick a
18 spot rate from the preceding 4 months. For assets and liabilities, the PPA methodology
19 helps smooth market volatility.

20 **Q. Why are these differences important?**

21 A. They help to explain, in addition to the difference in amortization periods, why funded status
22 and expense/contributions can vary considerably, and further justify why an adjustment
23 mechanism is appropriate for recovery of pension related costs.

B. Pension Adjustment Mechanism

1 **Q. Why is the Pension Adjustment Mechanism (PAM) appropriate?**

2 A. The PAM provides PGE the opportunity to recover prudently incurred pension expense and
3 financing costs for cash contributions that are required per the Pension Protection Act, as
4 discussed above. Given the differences between pension expense and PPA cash
5 contributions, and the market volatility the pension plan is exposed to, this mechanism
6 ensures that PGE recovers only its prudently incurred costs.

7 **Q. Please describe the proposed PAM.**

8 A. Similar to the Annual Update Tariff, PGE proposes that the Commission establish a separate
9 tariff for the PAM. This mechanism would include an annual update of rates based on a
10 forecast of future expected pension expense and cash contributions, with new rates effective
11 January 1 of the prospective year. The mechanism would also recover differences between
12 forecast and actual expense, and would update the basis for recovery of financing costs
13 based on actual expense and cash contributions.

14 **Q. Please provide a hypothetical example of how this mechanism would work.**

15 A. We outline the steps below:

- 16 • PGE begins by submitting a forecast of pension expense and cash contributions
17 for the test period.
- 18 • Subsequent to OPUC approval of the forecast, PGE creates a regulatory asset
19 (“financing basis”) for the difference between cash contributions and pension
20 expense. This balance is the basis for PGE’s financing costs for the test period.
- 21 • On January 1 of the test period PGE begins recovering its forecasted pension
22 expense and financing costs.

- 1 • During the test period, PGE tracks actual pension expense and cash contributions.
- 2 • By October 1 of the test period, which is now the current year, PGE submits an
- 3 update to the tariff (see PGE Exhibit 1500 and 1501 for pricing and tariff details)
- 4 for the ensuing year. In this filing, PGE will: 1) detail the difference between
- 5 forecast and actual pension expense for the current year, 2) provide the amount of
- 6 actual cash contributions for the current year, and 3) provide a forecast of pension
- 7 expense and cash contributions for the upcoming year.
- 8 • On January 1 of the upcoming year, PGE's prices would include the new pension
- 9 expense forecast net of the difference between forecast and actual pension
- 10 expense from the prior period. PGE would also update its financing basis to the
- 11 actual net cash contribution from the prior period net of the forecasted difference
- 12 between cash contributions and pension expense.

13 **Q. How is financing basis affected by a general rate case?**

14 A. Between rate cases, the financing basis in the tariff is reduced by the forecasted difference
15 between pension expense and cash contributions from the most recent rate case. At the time
16 of the next general rate case, the financing basis in its entirety, plus the forecast for the test
17 year, will be included in base rates along with the forecast of pension expense (much like
18 this filing). In other words, at the time of a general rate case, the PAM tariff will be reset to
19 zero.

20 **Q. On which interest rate would PGE base its interest costs on?**

21 A. For the interest component of the financing costs, PGE would use its pre-tax cost of capital
22 due to the long-term nature of the underlying costs.

1 **Q. If PGE were granted recovery of only pension expense, wouldn't PGE's pension plan**
2 **be made whole over time?**

3 A. Not necessarily. First, PGE's pension expense recovery is currently only updated during a
4 general rate case and does not have a true-up mechanism. This leads to variations between
5 what is collected in rates and actual expense in the years between rate cases as well as the
6 test year. Pension expense is expected to vary significantly from year to year over the next
7 several years (see PGE Confidential Exhibit 502C). Second, PGE is subject to considerable
8 financial volatility associated with the earnings of the pension plan, which is exacerbated by
9 the differences between FAS expense and PPA cash contributions. Pension expense is
10 amortized over a much longer period than that of the PPA funding requirements. As a
11 result, contributions that PGE is required to make are likely to vary significantly from
12 pension expense, particularly during years where the pension plan is under-funded for PPA
13 purposes. PPA cash contributions are required, and PGE would have to, for example, issue
14 equity and/or debt to fund the contributions. This would have a detrimental impact on
15 PGE's capital structure and earnings potential due to un-recovered financing costs. Both
16 items will adversely affect PGE's ability to attract necessary capital.

17 **Q. How do PGE's customers benefit from the PAM?**

18 A. As mentioned above, pension expense has a great deal of volatility. Actual pension expense
19 can also vary from forecast for a number of reasons including factors that are out of PGE's
20 control such as the recent market performance and changes in discount rates. The PAM
21 would ensure that PGE's customers are responsible only for PGE's actual expense, which
22 may include reducing costs for customers between rate cases. Further, the PAM is expected
23 to minimize the variation of costs to customers in any given year when compared to either

1 the lump-sum contribution option or only updating expense and financing costs during a
2 general rate case. The PAM also better aligns costs with customer benefits by ensuring
3 recovery of PGE’s actual costs. Such costs are part of the total cost of providing customers
4 with safe, reliable electric service.

5 **Q. What is PGE’s forecast 2011 pension revenue requirement?**

6 A. We forecast \$7.3 million of pension revenue requirement based on \$5.8 million of pension
7 expense and \$1.3 million of financing costs in 2011 (plus a gross-up for revenue sensitive
8 costs).

C. Pension Investment Strategy

9 **Q. What is the new investment strategy expected to accomplish?**

10 A. As mentioned previously, PGE has taken steps to manage its pension benefit obligation and
11 we propose to better align the pension assets with pension liabilities to minimize volatility in
12 pension expense and cash contributions. This will be accomplished by modifying the
13 pension’s asset allocation over a period of years. The goal is to ensure that changes in
14 market performance or discount rates that result in an increase or decrease to the pension
15 benefit obligation also result in a corresponding increase or decrease to the value of pension
16 assets, thereby reducing pension expense and cash contribution volatility.

17 **Q. How is PGE’s asset allocation expected to change over time under the new strategy?**

18 A. Pension assets are currently allocated as follows: 39% US Equities, 23% Non-US Equities,
19 33% Fixed Income, and 5% Private Equities. Over time, PGE would reallocate equity
20 investments into fixed income investments in order to achieve the alignment described
21 above. This alignment can be considered in terms of how much a pension’s assets are
22 “matched,” or “hedged,” against its liabilities. Currently, in PGE’s case, pension assets are

1 approximately 18% hedged, which is typical for similar plans. Ultimately, PGE will hedge
2 the majority of the portfolio.

3 **Q. Why is PGE making this change and over what time period?**

4 A. A combination of the PPA requirements and recent market performance has caused many
5 companies, including PGE, to reevaluate their pension investment strategy. PGE believes
6 such a change is in the best interest of both PGE and its customers because it will reduce
7 pension expense and cash contribution volatility, which translates into lower costs for PGE
8 and customers over the long-term. PGE will be looking for market opportunities to change
9 its asset allocation, and is currently evaluating the proper market indicators and benchmarks
10 for determining when and how to reallocate. PGE expects the reallocation to take several
11 years.

12 **Q. What is the effect of changing the asset allocation on pension expense and cash
13 contributions?**

14 A. As we mentioned previously, the effect will be less volatility in pension expense and cash
15 contributions. As PGE reallocates assets from equities to fixed income, the pension plan's
16 expected rate of return is expected to decrease.

VI. Summary and Qualifications

1 **Q. Please summarize your testimony.**

2 A. PGE must provide a total compensation package sufficient to attract, retain, and encourage
3 performance beneficial to PGE and our customers. Thus, PGE designs its total
4 compensation program with reference to the labor markets in which we compete. This
5 approach provides a total compensation structure, comprised of wages and salaries,
6 incentives, and benefits, that as proposed will be competitive and cost effective.

7 **Q. Ms. Barnett, please summarize your qualifications.**

8 A. I received a Bachelor of Arts degree from Abilene Christian University in 1972 and
9 certification in Human Resources at Portland State University. I have completed
10 coursework toward an MBA in Human Resources at the University of Portland. As Vice
11 President of Administration, I oversee Business Continuity and Security, and Human
12 Resources areas.

13 I joined PGE in 1978 and have successfully bid and been selected for various positions
14 at PGE. I guided the HR department through the merger with Enron in 1997 and became
15 Vice President in 1998.

16 **Q. Ms. Bell, please summarize your qualifications.**

17 A. I received a Bachelor of Arts degree from the University of Pittsburgh in 1975. I received a
18 Masters in Business Administration from the Joseph M. Katz Graduate School of Business,
19 University of Pittsburgh, in 1976. Prior to joining PGE, I worked at Fireman's Fund
20 Insurance, Co. and American Express in finance; and at Baltimore Gas & Electric Company
21 in the areas of finance and human resources. In 1988, I joined Portland General Electric and
22 I have been Director of Compensation and Benefits since 1998.

- 1 **Q. Does this conclude your testimony?**
- 2 A. Yes.

List of Exhibits

<u>PGE Exhibit</u>	<u>Description</u>
501	Historical Pension Details (1998 – 2008)
502C	Pension Plan Projections