

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION )  
OF IDAHO POWER COMPANY FOR )  
AUTHORITY TO INCREASE ITS RATES )  
AND CHARGES FOR ELECTRIC SERVICE )  
TO ELECTRIC CUSTOMERS IN THE STATE )  
OF IDAHO. )  
\_\_\_\_\_)

CASE NO. IPC-E-05-28

IDAHO POWER COMPANY

DIRECT TESTIMONY

OF

LUCI K. McDONALD

1 Q. Please state your name, position of  
2 employment, and your business address.

3 A. My name is Luci K. McDonald. I am the Vice  
4 President of Human Resources for Idaho Power Company (Idaho  
5 Power or the Company). I also hold this position with  
6 IDACORP, Inc.

7 Q. Please describe your relevant employment  
8 history.

9 A. I spent over 20 years in various Human  
10 Resource positions at Boise Cascade Corporation including  
11 five years as a specialist in Salary Administration and  
12 Executive Compensation and 15 years as a Human Resource  
13 generalist in progressively more responsible positions. I  
14 spent five years as the Human Resource Manager for the  
15 Packaging Division and the last five years before coming to  
16 Idaho Power, as the Director of Human Resources for  
17 Corporate Staff.

18 In December of 2004, I accepted an offer from  
19 Idaho Power Company to become Vice President of Human  
20 Resources. In this capacity, I am responsible for employee  
21 benefits, compensation, corporate development, employee  
22 relations, safety and security, and employee environmental  
23 concerns.

24 Q. Please describe your educational background  
25 and professional affiliations.

1           A.       I hold a B.A. in Business Management, with an  
2 option in Human Resources from Boise State University. I am  
3 a member of World at Work and the Society for Human Resource  
4 Management.

5           Q.       What is the purpose of your testimony in this  
6 proceeding?

7           A.       I will describe Idaho Power's approach to  
8 employee compensation. I will also discuss the Company's  
9 annual salary structure adjustment and the Company's  
10 employee incentives.

11          Q.       Are you sponsoring any exhibits?

12          A.       Yes. I am sponsoring Exhibit 19 entitled  
13 2005 Incentive Plan Targets, which describes Idaho Power's  
14 employee incentive program for 2005.

15          Q.       Please describe Idaho Power Company's  
16 approach to employee compensation.

17          A.       Idaho Power's compensation philosophy is  
18 generally based on achieving four goals: (1) facilitating  
19 the achievement of Idaho Power's vision, mission, and goals;  
20 (2) attracting, retaining and motivating employees with the  
21 skills and performance level to achieve the goals of the  
22 Company; (3) being market competitive in compensation and  
23 benefits in labor markets where the company competes for  
24 employees; and (4) providing opportunities for employee  
25 development and advancement.

1           Q.       Has the Company's compensation philosophy  
2 evolved over time?

3           A.       Yes. Prior to 1991, the Company's  
4 compensation goal was focused on providing a wage and  
5 benefit package that was sufficiently competitive within the  
6 region. To assure compliance with that goal, Idaho Power  
7 annually conducted a survey of Pacific Northwest utilities  
8 focusing on the "lineman" position. Based on that survey,  
9 management would recommend to the Board a general wage  
10 adjustment (GWA) that would maintain the compensation for  
11 the Company's linemen and other skill/craft positions at a  
12 level that was at or near the top of the market in the  
13 northwest. The GWA was the predecessor to the current  
14 Salary Structure Adjustment (SSA).

15          Q.       Were changes to the compensation program  
16 implemented in 1991?

17          A.       Yes. In 1991, Idaho Power adopted a number  
18 of structural changes to its cash compensation program. At  
19 that time the compensation market was expanded beyond the  
20 Pacific Northwest to encompass the Intermountain West  
21 utility industry and the competitive level for cash  
22 compensation was set at the 60<sup>th</sup> percentile of that market.  
23 Idaho Power also moved away from a single competitive  
24 benchmark position (lineman) comparison in the market to a  
25 salary benchmarking process that included approximately

1 seventy union, professional, supervisory and administrative  
2 positions that were reviewed annually to determine the  
3 amount of adjustment necessary to maintain the overall  
4 competitiveness of the compensation structure.

5 Q. Does the Company currently include an SSA as  
6 part of its compensation package?

7 A. Yes.

8 Q. What is its purpose?

9 A. The Salary Structure Adjustment or SSA is a  
10 process reviewed annually in the early Fall. The purpose is  
11 to review key factors to keep our salary structure  
12 competitive with other companies. The SSA is not intended  
13 to be a cost-of-living adjustment nor is it guaranteed that  
14 the Company will adjust the structure every year. In the  
15 SSA review process, Idaho Power gathers and analyzes data  
16 from the following sources: (1) preliminary results of our  
17 annual wage study - which is a comparison of our pay for  
18 certain benchmark jobs to the market pay for the same jobs;  
19 (2) data of other local companies on their plans for a  
20 salary structure adjustments; (3) bargaining unit and non-  
21 bargaining unit adjustments made by other northwest  
22 utilities; and (4) the Consumer Price Index through  
23 September of each year. All of the above information is  
24 considered as well as the impact of an estimated increase in  
25 compensation costs on the Company. Overall, the Company

1 considers what is necessary to remain competitive and avoid  
2 other costs such as those related to turnover. A final  
3 recommendation is made to our Board of Directors'  
4 Compensation Committee. If an SSA is approved by the  
5 Compensation Committee, it is effective January of the  
6 ensuing year.

7 Q. Are you familiar with the Company's past  
8 employee incentive programs?

9 A. I am generally familiar with Idaho Power's  
10 historic approach to incentive programs. Additionally, my  
11 career in human resources has exposed me to a variety of  
12 corporate incentive plans.

13 Q. Please describe the Company's historic  
14 approach to incentive programs.

15 A. The Company's first employee incentive plan  
16 began in 1995 with the implementation of a compensation  
17 program that designated a portion of the compensation to be  
18 "at-risk-pay" based upon meeting predetermined goals. Until  
19 1995 most of the employees were paid base wages or salaries  
20 only.

21 Q. Why do refer to the annual incentive program  
22 as at-risk-pay?

23 A. Unlike base pay, which is guaranteed,  
24 incentive pay will not be paid unless the Company's  
25 performance meets or exceeds predetermined goals. For

1 example, in 2003 no incentive payout was made to Company  
2 employees.

3 Q. Please describe the goals Idaho Power has  
4 historically used to establish employee incentives.

5 A. Originally the Company established goals  
6 based on controlling O&M costs, customer satisfaction, and  
7 safety. Beginning in 1997 Idaho Power moved to focus  
8 employees on continuous process improvement with the goal of  
9 each employee contributing toward this process. At that  
10 time the Company concluded that an earnings-oriented goal  
11 provided an objective, auditable metric for performance  
12 under the plan. In 1997, the Company made the decision to  
13 change the plan to a single goal of earnings on common  
14 shares of Idaho Power Company (later IDACORP) with the  
15 performance level set independently by the Compensation  
16 Committee of the Company's Board of Directors.

17 Q. What criticisms have been expressed  
18 concerning past employee incentive programs that focus  
19 predominantly on earnings per share?

20 A. In short, while employee incentives that are  
21 based on increased earnings may have an indirect benefit to  
22 the customer, they have a more direct benefit to the  
23 shareholder. Accordingly, the common conclusion by  
24 regulators is that the cost of earnings-based incentives  
25 should be only borne by the shareholder. Additionally, many

1 regulators have asserted that if an incentive is to be  
2 recovered from the customers in rates, there should be a  
3 direct benefit to the customers resulting from the incented  
4 actions.

5 Q. What has the Company done to address these  
6 criticisms?

7 A. Idaho Power has revised its incentive program  
8 to encourage both direct customer benefits and direct  
9 shareholder benefits. I understand that the portion of the  
10 incentive program related directly to shareholders has been  
11 removed from the Company's rate request, while the targeted  
12 amount associated with customer benefits has been included.

13 Q. Please describe the design of the 2005  
14 customer benefit incentive program?

15 A. Please refer to Exhibit 19, which explains  
16 the program in greater detail. In summary, the customer  
17 benefit incentive program includes two components: (1) the  
18 Customer Relationship Index (CRI), and (2) the combined  
19 Operating and Maintenance (O&M) and Capital expenditures for  
20 the year. The first component, the CRI, was at an all time  
21 high of 79.0% in the fourth quarter of 2004. While it is  
22 not clear how much more the CRI can be improved, the  
23 customer benefit program incents employees to maintain at  
24 least a level of 78.5% for a one percent payout. If the CRI  
25 is improved and maintained through the year to a level of

1 79.25%, employees will receive a target payout of 1.75%. If  
2 the CRI reaches a maximum of 80.0% in the fourth quarter of  
3 2005, the payout will be 2.5% of base pay.

4 The second component, O&M and Capital Expenditures  
5 is based on a budget of \$428.8 million for the two items.  
6 The threshold payout of 1% will not be paid unless  
7 expenditures come within \$3.2 million of budget. The target  
8 payout of 1.75% on this component was set at \$427.0 million.  
9 This target rewards employees if actual expenditures are  
10 \$1.8 million under budget and the maximum payout of 2.5%  
11 will be paid only if expenditures are at least \$10.8 million  
12 under budget.

13 Q. Isn't there is a natural tension between the  
14 goals of customer satisfaction and budgetary management?

15 A. Yes. Either one of these goals standing  
16 alone would reward employees for behaviors that would not be  
17 positive for customers on a long-term basis. With the goals  
18 combined, employees are encouraged to find a balance.

19 Q. How do customers benefit from these  
20 incentives?

21 A. The CRI is a direct measurement of customer  
22 satisfaction. Mr. Baggs explains the CRI methodology and  
23 the Company's recent CRI performance in his testimony. The  
24 combined O&M and Capital expenditures benefit customers in  
25 that employees are incented to manage costs, which are

1 ultimately borne by the customers.

2 Q. Please explain how managing the capital and  
3 O&M expenditures in combination is beneficial to customers.

4 A. Obviously, Idaho Power customers benefit  
5 whenever the Company actively manages its costs. Since a  
6 major portion of the employee incentive is related to  
7 customer satisfaction, adding an additional incentive based  
8 on cost management creates a disciplined, prioritized  
9 approach to providing increased customer satisfaction.  
10 Additionally, by managing both capital and O&M expenditures  
11 in combination, the Company avoids encouraging employees to  
12 play budget classification games (i.e., moving what would  
13 normally be an O&M expense to capital or vice versa in order  
14 to stay within incentive targets). Finally, Idaho Power's  
15 customers especially benefit from a cost management focus  
16 during a test year because any benefits in expenditure  
17 reductions are captured immediately in rates.

18 Q. Has Idaho Power communicated these customer  
19 benefit incentives to its employees?

20 A. Yes. Idaho Power has held employee meetings  
21 where the plan design has been explained directly to  
22 employees; the plan is available on the Company's intranet;  
23 and numerous intra Company newsletter articles providing  
24 employees with information on the program and updates on the  
25 goals. These articles are included in my workpapers.

1 Q. What has been their reaction thus far?

2 A. As testified to by Mr. Baggs, the CRI has  
3 reached an all time high of 80.75 in the third quarter of  
4 2005. At present, this measure is on track to obtain the  
5 maximum level for the year.

6 Q. Is Idaho Power considering any plans that  
7 could improve the customer benefit portion of the employee  
8 incentive program in the future?

9 A. Yes, we see this as a continuous improvement  
10 process. Our next major effort will be to consider how  
11 improvements in system reliability could be measured and  
12 used as the third element of our customer-based incentive.  
13 Idaho Power plans to have a reliability incentive component  
14 prepared in time for 2006.

15 Q. Does this conclude your testimony?

16 A. Yes, it does.