EXHIBIT NO. ______

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio Power Company for an Increase in Electric Distribution Rates.	)))	Case No. 20-585-EL-AIR
In the Matter of the Application of Ohio Power Company for Tariff Approval.	)))	Case No. 20-586-EL-ATA
In the Matter of the Application of Ohio Power Company for Approval to Change Accounting Methods.	)))	Case No. 20-587-EL-AAM

DIRECT TESTIMONY OF
ANDREW R. CARLIN
ON BEHALF OF
OHIO POWER COMPANY

X Management Policies, Practices & Organizations

X Operating Income

X Rate Base

Allocations

Rate of Return

Rates and Tariffs

Other:

Filed: June 15th , 2020

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ANDREW R. CARLIN

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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO
DIRECT TESTIMONY OF
ANDREW R. CARLIN
ON BEHALF OF
OHIO POWER COMPANY

I. PERSONAL DATA

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Andrew R. Carlin, and my business address is 1 Riverside Plaza, Columbus, Ohio 43215.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

A. I am employed by American Electric Power Service Corporation ("AEPSC"), a wholly owned subsidiary of American Electric Power Company, Inc. ("AEP"), as Director Compensation & Executive Benefits. AEP is the parent company of Ohio Power Company ("AEP Ohio" or the "Company"). AEPSC supplies engineering, financing, accounting, human resources, and similar administrative, planning, and advisory services to AEP's regulated operating companies and other AEP subsidiaries. In this testimony, I refer to AEP Ohio and AEPSC collectively as the "Companies."

Q. WOULD YOU PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND?

A. I received a Bachelor of Arts Degree from Bowdoin College in 1988 with majors in both Economics and Government. I also received a Master of Business Administration Degree from the J. L. Kellogg Graduate School of Management at Northwestern University in 1992, with concentrations in finance, management strategy, and accounting.

From 1987 to 1988, I worked for Putnam Investor Services as a Shareholder Services Representative. From 1988 to 1990 and in the summer of 1991, I worked as an Associate Consultant and Research Analyst in the U.S. Compensation Practice for William M. Mercer, a leading international human resource consulting firm. From 1992 to 2000, I worked for Bank One Corporation, now J.P. Morgan Chase, in multiple planning, finance and compensation capacities.

I joined AEPSC as the Director of Executive Compensation & Benefits in 2000. In 2002, I took responsibility for employee compensation in addition to executive compensation and benefits.

Q. WHAT ARE YOUR RESPONSIBILITIES AS DIRECTOR OF COMPENSATION & EXECUTIVE BENEFITS?

A. With assistance from others members of my department and oversight from AEP management, I am primarily responsible for designing and administering compensation and executive benefits programs that attract, engage, motivate, and enable the Companies to retain current and prospective employees with the skills and experience needed to provide service to customers effectively, efficiently, and safely. The programs are components of a total compensation program that is designed to be market competitive overall. My team conducts ongoing research and recommends changes to compensation and benefit programs to maintain compensation and benefits at reasonable, prudent, and market-competitive levels in order to achieve these objectives. The team accomplishes this by comparing the Companies' compensation and benefits to that of other employers, primarily using third party surveys. See Exhibit ARC-1 for the list of compensation surveys used for compensation comparisons for the test year. The team also develops communications materials in support of compensation and benefit programs and monitors compliance with federal and state regulations related to compensation and benefits.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN ANY REGULATORY PROCEEDINGS?

A. Yes. Please see Exhibit ARC-2 for the list of regulatory proceedings in which I have testified.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to demonstrate that the compensation the Companies provide to employees and that AEP Ohio seeks to include in its cost of service for ratemaking purposes is reasonable, customary, prudent, and necessary for the provision of reliable electric service to customers in a safe, efficient, and effective manner. I will demonstrate that the Companies' employee compensation is prudently designed, effectively managed, reasonable, and market-competitive. I will also show that the provision of market-competitive compensation is necessary for the attraction and retention of employees with the skills and experience necessary to provide reliable electric service, at a reasonable cost, efficiently, effectively, and safely to AEP Ohio customers. My testimony will demonstrate that reasonable, market-competitive compensation includes a combination of both Base Pay and incentive compensation that benefits customers by improving the cost and quality of the work that employees perform for customers. I will show that the market-competitive compensation opportunity provided by the Companies is vital for recruiting, engaging, retaining, and directing the efforts of employees with the skills and experience necessary to efficiently, effectively, safely, and reliably provide electric service to AEP Ohio customers.

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Yes, I am sponsoring the following exhibits:

Exhibit ARC-1 - Compensation Survey List

Exhibit ARC-2 - Previous Rate Case Testimony List

Exhibit ARC-3 - Target TCC vs. Market for Technical, Craft & Clerical Positions

Exhibit ARC-4 - Target TCC vs. Market for Nonexempt Salaried Positions

Exhibit ARC-5 - Target TCC vs. Market for Exempt Positions

Exhibit ARC-6 - Target TCC vs. Market for Executive Positions

Exhibit ARC-7 - 2020 AEP Ohio STI Performance Measures

III. OVERVIEW OF COMPENSATION PRACTICES

Q. WHAT ARE THE COMPENSATION TERMS USED IN THIS TESTIMONY?

A. The Companies compensate all employees, except coop students and interns, with a combination of a fixed base wage or salary ("Base Pay") and a variable annual, short-term incentive compensation ("STI") opportunity. I refer to the sum of these two types of compensation (Base Pay + STI) as Total Cash Compensation ("TCC").

Approximately 1,236 positions in the AEP system also have a regular annual long-term incentive ("LTI") compensation opportunity. These positions require unique skills and involve roles for which long-term continuity, prudency, and vision are required.

Total Compensation ("Total Compensation") is comprised of Base Pay, STI and, for eligible positions, LTI (Base Pay + STI + LTI = Total Compensation). I refer to the sum of STI and, if applicable, LTI collectively as ("Incentive Compensation"). Total Compensation and TCC are the same for employees who do not have an LTI opportunity.

Q. PLEASE DESCRIBE THE VARIOUS TYPES OF EMPLOYEES THAT WORK FOR THE COMPANIES AND HOW EACH TYPE OF EMPLOYEE IS COMPENSATED.

A. The Companies employ physical, craft, and technical employees, such as line mechanics, who are paid an hourly wage and a target level of STI opportunity. Wage increases for these employees primarily take the form of an annual general wage increase, which ensures that the Companies' wages keep pace with labor market inflation. The Companies also provide equity adjustments to address gaps to market-competitive wages and to standardize wages with those of other AEP operating companies. The Companies negotiate wage rates and wage increases for most physical, craft, and technical employees with labor unions as part of a collective bargaining agreement. The Companies consider reasonable and market-competitive compensation rates in determining their position for labor negotiations. Collectively bargained rates are generally mirrored in setting wages for unrepresented physical, craft, and technical employees. As a result, the wages the Companies offer to employees for both represented and unrepresented physical, craft, and technical positions are closely aligned with market-competitive compensation.

Physical, craft, and technical employees also progress through job steps and job levels as they accumulate the experience and other qualifications needed to perform more demanding, dangerous, and difficult work safely. For example, in order to progress from Line Mechanic B, step 4, Line Mechanics must complete the experience and other qualifications for the Line Mechanic A, step 1 level. Once an employee progresses to a new job step or level, they begin receiving both the pay and work responsibilities associated with the higher position.

The Companies also employ non-exempt salaried employees as well as exempt professional, managerial, and executive employees. Employees in these types of positions participate in an annual performance review and merit pay program, along with the annual STI program. Some professional positions, most managerial positions, and all executive positions also participate in an LTI program. AEPSC's Compensation team compares the compensation for these positions to market survey information to assign or reassign positions to salary grade levels and recommend compensation and other changes to maintain Total Compensation at reasonable and market-competitive levels.

Q. DO THE COMPANIES FACE COMPETITION FOR SUITABLE EMPLOYEES?

A. Yes, the Companies are in continuous competition to attract and retain suitable employees for nearly all types of positions. The competition is particularly stiff and relentless for fully trained employees with the necessary skills and experience needed to provide service to customers efficiently, effectively and safely. The Companies' current and prospective employees largely have other options and no pressing need to accept or continue an employment relationship with the Companies. The Companies compete for these employees with contractors both within and outside our service territory, as well as with employers in other industries, such as construction. Contractors perform roughly half of the Companies' physical, craft, and technical work, and the entities that perform this work compete with the Companies, directly or indirectly, for suitable employees. Contractors are free to structure the mix of base pay and incentive compensation they offer to employees in any manner that the labor market will bear. The market survey data shows that, at the median, employers provide Incentive Compensation to all of the Companies' positions. (This is discussed in more detail in the COMPETITIVENESS OF TOTAL COMPENSATION section below). As a result, it is likely that a significant portion of the cost of the Companies' contract labor is for incentive compensation.

Q. WHAT IS THE COMPANIES' OVERALL APPROACH TO COMPENSATION?

A. The Companies' compensation strategy for all types of positions is to provide a Total Compensation opportunity that is, on average, at the median of the Total Compensation opportunities provided for similar positions in the labor market from which the Companies attract and retain employees for each position. For positions that are specific to the energy services industry, the Companies use energy services industry specific compensation survey data, which is the only data available for positions specific to the energy services industry. For positions found in multiple industries, the Companies use the largest possible sample of compensation survey information, which is general industry survey data. In both cases, since AEP operates in multiple states and regions of the United States, the Companies use U.S. national compensation survey data, which also has the benefit of providing the largest and most statistically significant possible sample.

The Total Compensation opportunity that the Companies provide is comprised of Base Pay and a variable 'at risk' Incentive Compensation opportunity. Focusing on the Total Compensation opportunity, rather than Base Pay alone, is the correct methodology because it takes all statistically significant types of compensation into account. This approach better enables the Companies to compete effectively with other employers in the labor market in attracting and retaining the suitably qualified employees needed to provide service to AEP Ohio's customers.

Q. DOES THE USE OF MARKET MEDIANS AS BENCHMARKS MEAN THAT EMPLOYEE COMPENSATION WILL GENERALLY BE AT THE MEDIAN?

A. Not necessarily. First, since market compensation rates move in ways that are not always predicable, the Companies design compensation to be within a market-competitive range around the market median. In addition, salary ranges for each salary grade extend approximately 22.5 percent above and below the midpoint, and the salaries for individual salaried employees may fall anywhere within the assigned range depending on individual performance, qualifications, time in job, and other factors.

Q. HOW DO YOU DETERMINE THAT TOTAL COMPENSATION LEVELS ARE REASONABLE AND MARKET-COMPETITIVE?

A. The Compensation team compares the Companies' compensation levels and practices to those of similar employers for similar positions to ensure that they are reasonable and market-competitive. The Compensation team relies on third-party compensation surveys to provide robust market compensation benchmarks based on statistically sound survey methodologies, including extensive and independently verified compensation information for statistically significant samples of incumbents in a wide variety of jobs.

In order to make these comparisons, the Compensation team matches the Companies' positions to the survey positions based on each jobs function, specialty, level, and other factors. The Compensation team then compares the Companies' compensation levels and practices to the survey sample to determine the best compensation benchmark for the matched jobs, taking into account any material differences in each position's scope. The Compensation team generally uses market median Total Compensation as the primary compensation benchmark for each job. The Compensation team also uses Base Pay and, when applicable, TCC as additional points of comparison. The Compensation team then assigns each merit pay eligible position to a salary grade, with an associated salary range, STI target and, if applicable, LTI target. The Compensation team assigns a salary grade that best fits each position's market-competitive compensation benchmark, while also providing a smooth grade progression for job families and internal equity. The Compensation team also uses this process to periodically review and, as needed, update compensation rates, salary grades, incentive targets and other compensation practices to maintain market-competitive compensation for each position. This process is consistent with the compensation practices of the vast majority of electric utilities and other large U.S. companies. The market compensation surveys completed and used in this process to evaluate compensation for the test year are listed in Exhibit ARC-1.

Q. WHY IS AN EMPLOYEE'S TOTAL COMPENSATION CHOSEN AS THE PRIMARY POINT OF COMPARISON RATHER THAN BASE SALARY LEVELS?

A. The Compensation team uses Total Compensation as the primary point of comparison because it includes all statistically significant types of employee compensation. Only with the variable incentive portion does the Companies' Total Compensation generally reach a reasonable and market-competitive level. Survey information shows definitively that the STI is a significant component of market-competitive compensation for all of the Companies' positions. Likewise, survey information shows that LTI is a significant and often substantial component of market-competitive compensation for those positions that are generally eligible to participate in the Companies' LTI program. Therefore, no assessment of market-competitive compensation for the Companies' positions would be valid without including both these types of Incentive Compensation.

In addition, because the Compensation team considers the value of Incentive Compensation provided by both the market and the Companies in assigning job grades to positions, the Companies' Base Pay levels are typically lower than employers that provide less or no Incentive Compensation opportunity. Because the percentage of Base Pay, STI, and LTI in Total Compensation can vary significantly across employers, compensation analyses that do not consider Total Compensation are incomplete and can only provide apples to oranges comparisons.

IV. <u>ACTIONS TAKEN TO CONTROL COMPENSATION EXPENSE</u>

Q. HOW DO THE COMPANIES' BASE PAY INCREASES COMPARE TO THOSE OF OTHER UTILITY INDUSTRY EMPLOYERS?

A. The Companies' total Base Pay increases for employees other than those in hourly physical, craft, and technical positions lagged the market median rate of Base Pay increases over the period 2009 through 2020, particularly for executive positions, as Table 1 below demonstrates. This lag is primarily the result of a salary freeze in 2009 for most positions and in 2009 and 2010 for executive positions. The Companies implemented this salary freeze in response to the Great Recession that began in 2008. Table 1 below compares the Companies' salary increase budgets to median utility industry Base Pay increase budgets for employees other than those in hourly physical, craft, and technical positions for the years 2009 through 2020 (projected).

Table 1						
	Nonexempt Salaried		Exempt		Executive	
	Industry*	Companies	Industry*	Companies	Industry*	Companies
2009	2.75%	0.00%	2.50%	0.00%	2.00%	0.00%
2010	2.70%	2.00%	3.00%	2.00%	2.95%	0.00%
2011	3.00%	3.20%	2.90%	3.20%	3.00%	3.20%
2012	2.75%	2.68%	3.00%	2.68%	3.00%	2.68%
2013	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
2014	3.00%	3.35%	3.00%	3.35%	3.00%	3.35%
2015	3.00%	3.50%	3.00%	3.50%	3.00%	3.00%
2016	3.00%	3.50%	3.00%	3.50%	3.00%	3.00%
2017	3.00%	3.50%	3.00%	3.50%	3.00%	3.50%
2018	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
2019	3.00%	3.50%	3.00%	3.50%	3.00%	3.50%
2020**	3.00%	3.50%	3.00%	3.50%	3.00%	3.50%
Total	35.20%	34.73%	35.40%	34.73%	28.95%	31.73%
Difference		-0.47%		-0.67%		-2.78%

*The Conference Board Research Report, U.S. Salary Increase Budgets for 2010-2020
**Projected 2020 market median vs. the Companies' 2020 actual salary increase budget which was implemented as budgeted and resulted in salary increases effective April 1, 2020

For hourly physical, craft, and technical employees, Base Pay increases also lagged the market during this period. Table 2 below shows that for the period 2009 through 2019 (projected), the Companies' Base Pay increases for hourly physical, craft, and technical employees lagged the market median by 1.75 percent.

Table 2		
	Hourly Physical, Craft, and Technical Employees	
Year	Utility Industry Market Median*	Companies
2009	2.50%	0.00%
2010	2.85%	2.00%
2011	2.90%	3.00%
2012	3.00%	2.00%
2013	3.00%	2.50%
2014	3.00%	2.50%
2015	3.00%	3.50%
2016	3.00%	3.50%
2017	3.00%	5.00%
2018	3.00%	2.50%
2019	3.00%	3.50%
2020**	3.00%	3.50%
Total	35.25%	33.50%

Difference	-1.75%
* The Conference Board Research Report, U.S. Salary Increase Budgets for 2010-2020 **Projected 2020 market median vs. the Companies 2020 collectively bargained 2020 wage increases.	

These tables show that the Companies' Base Pay increase budgets substantially lagged the market median in 2009 and 2010 and have yet to make up the lost ground. Reducing the growth of employee salaries during times of pervasive and substantial economic distress is one of several difficult steps that the Companies' management and employees have taken to control labor expense. The impact of these decisions is still seen, as the above tables show, in the Companies' Base Pay levels for all types of employees to this day. These actions, along with continued employee teamwork and commitment, directly reduced the cost of providing electric service to AEP Ohio customers and the savings that remain will again be passed on to Ohio customers as part of this rate proceeding.

Q. DID THE COMPANIES IMPLEMENT SALARY AND WAGE INCREASES FOR ALL CLASSES OF EMPLOYEES IN 2020?

A. Yes. As noted in Tables 1 and 2 above, the Companies implemented 3.50% salary increases effective April 1, 2020 and have implemented or are contractually committed to implement Base Pay increases effective on collectively bargained dates throughout the remainder of the year.

V. <u>COMPETITIVENESS OF TOTAL COMPENSATION</u>

Q. SHOULD BOTH BASE PAY AND INCENTIVE COMPENSATION BE CONSIDERED PART OF AN OVERALL REASONABLE LEVEL OF TOTAL COMPENSATION FOR RATE SETTING PURPOSES?

A. Yes. This is true irrespective of the form this compensation takes, be it a mix of Base Pay and Incentive Compensation or 100 percent Base Pay. The Companies compete for employees with a great many other employers, the majority of which offer Incentive Compensation to the employees over which we compete. The Public Utilities Commission of Ohio (the "Commission") should look to whether Total Compensation is within the market-competitive range because such competitive compensation is needed to attract and retain employees with the knowledge, experience, and qualifications needed to provide reliable electric services to customers efficiently, effectively and safely, while minimizing overall expense.

Although reducing Total Compensation to less than the market-competitive range would reduce compensation expenses, this cost reduction would likely be more than offset by increased hiring and training expenses due to increased employee turnover, as well as lower employee productivity, given the many years it often takes new employees to learn to perform their jobs safely, efficiently, and effectively. This is particularly true for positions that require lengthy apprenticeships to learn the skills needed to work independently and safely, such as the lineman job family, which requires five years to reach the journeyman level. In addition, it generally takes 30-60 days to fill vacant positions and much longer for new employees to come up to speed on new duties, work processes and safety procedures. This lost or reduced productivity often must be backfilled by employees who are less efficient at it, such as employees who normally perform other duties, or who are more expensive, such as the vacant position's supervisor. Employee turnover gives rise to many other incremental costs beyond the examples cited above. The incremental cost and reduced service quality that results from increased employee turnover are the reasons that the provision of market competitive Total Compensation is in the interests of AEP Ohio's customers.

Q. HOW DOES TARGET TOTAL COMPENSATION FOR HOURLY PHYSICAL, CRAFT, AND TECHNICAL POSITIONS COMPARE WITH MARKET DATA?

A. As shown in Exhibit ARC-3, AEP Ohio's average target TCC for 503 hourly physical, craft, and technical positions in 15 different jobs was 7.3 percent below the market median at year-end 2019.[1] Assuming a market-competitive compensation range of +/- 10 percent of the survey median, which is typical practice for such positions, this shows AEP Ohio's average target TCC is within but in the lower half of the market-competitive range. However, target TCC for 13.3 percent of these positions was below the market-competitive range, and none was above the market-competitive range. This clearly shows that AEP Ohio's Total Compensation for these positions, including the incentive portion, was reasonable relative to market-competitive rates.

Comparing Base Pay to market target TCC further confirms that the Company's TCC, inclusive of STI, is market competitive. If STI were excluded (*i.e.*, comparing the Company's Base Pay to market TCC) as shown by the graph in Exhibit ARC-3, then 60 percent of the Company's jobs would be below the market-competitive range and the Company's average target TCC would be 12.7 percent below the market median.

[1] Data source: EAPDIS, LLC, 2019 Energy Technical Craft Clerical Survey – ETCCS, except as otherwise noted in Exhibit ARC-3.

Q. ARE THERE DISCIPLINES FOR WHICH MARKET-COMPETITIVE TOTAL COMPENSATION IS INCREASING FASTER THAN FOR OTHER POSITIONS?

A. Yes, certainly. One recent example is the vegetation management discipline, for which compensation increased 3.7% for 2019, compared with 2.0% for other craft positions. The increased rate of compensation growth for this discipline has implications for both the compensation for some AEP Ohio employees and AEP Ohio's cost for outsourced contract forestry work. Employers often have little choice but to react to labor supply shortages by increasing the compensation they pay for employees that are in short supply. Cyber-security and data science are two other examples of disciplines for which compensation has been increasing at significantly higher rates.

Q. HOW DOES TARGET TOTAL COMPENSATION FOR SALARIED NONEXEMPT POSITIONS COMPARE WITH MARKET DATA?

A. Exhibit ARC-4 indicates that, on average, AEP Ohio's target TCC for 44 salaried nonexempt positions with 635 employees is well within the market-competitive range. However, similar to the compensation for hourly employees and consistent with the Companies' Total Compensation design, STI is an integral component of the market-competitive Total Compensation Opportunity for these employees. If STI is excluded, as shown by the graph in Exhibit ARC-4, then the average target TCC for these positions would be 2.9 percent below the market median and 20 percent would be paid below the market-competitive range.

Q. HOW DOES TARGET TOTAL COMPENSATION FOR NON-MANAGERIAL EXEMPT POSITIONS COMPARE WITH MARKET DATA?

A. Exhibit ARC-5 compares the Company's compensation for non-managerial exempt positions to market survey information[2] using a slightly broader +/- 15 percent of market median as the market-competitive range, which is typical for exempt positions. The average target TCC for these positions was close to the market median but, if STI were excluded, as shown by the graph in Exhibit ARC-5, then the average target TCC for these 244 positions with 2,227 employees would be 11.1 percent below the market median and a third of these positions would be paid below the market-competitive range.

Q. HOW DOES TARGET TOTAL COMPENSATION FOR EXECUTIVE POSITIONS COMPARE WITH MARKET DATA?

A. The Human Resources Committee of AEP's Board of Directors ("HR Committee") annually engages a nationally recognized, independent executive compensation consulting firm to conduct a compensation study of the Companies' executive positions. The peer group used for this study consists of companies specifically selected by the HR Committee to represent the talent markets within which the Companies must compete to attract and retain senior management and executive employees. For the 2019 study, executive compensation was market-competitive overall and close to the market median on average for the 15 executive positions included in their analysis whose compensation is billed to AEP Ohio (See Exhibit ARC-6). However, as shown in the graph in Exhibit ARC-6, Total Compensation would be below the market-competitive range for 100 percent of these

[2] Sources: Willis Towers Watson 2019 Energy Services Middle Management & Professional Survey and Willis Towers Watson 2019 General Industry Middle Management & Professional Survey, April 2019.

executive positions without either the STI or LTI portions of their total compensation and, obviously, even further below without both of these types of incentive compensation.

Q. IS THE COMPENSATION OPPORTUNITY THAT THE COMPANIES' INCENTIVE COMPENSATION PROVIDES NECESSARY FOR ATTRACTING AND RETAINING SUITABLE EMPLOYEES?

A. Yes. Exhibits ARC-3 through ARC-6 show that the total compensation offered to employees for all types of positions is both reasonable and market-competitive. They also show that without the target value of Incentive Compensation, the compensation opportunity that the Companies provide to employees would not be market-competitive in many cases. For higher-level management and executive positions, the portion of compensation provided by STI and LTI compensation is necessary, both individually and in combination, to maintain any semblance of market-competitive total compensation for these positions. It is likely that, without the compensation opportunity that Incentive Compensation provides, the Companies would experience increased turnover among all categories of employees and potentially problematic turnover for the many positions for which the average TCC would then be below the market-competitive range. Turnover becomes problematic when the Companies cannot retain sufficiently skilled and experienced employees or a sufficient number of employees to provide service efficiently and effectively to customers, resulting in longer outages and increased costs to customers. This shows that the portion of compensation provided by STI for all types of employees is necessary to maintain the competitiveness of the Companies' TCC and Total Compensation for these positions. As such, the target expense associated with the Companies' incentive compensation for all types of positions, irrespective of the form in which it is provided, is a necessary, reasonable, and appropriate cost of doing business that AEP Ohio should be allowed to fully recover in its cost of service.

Q. DOES ANY PORTION OF THE COMPENSATION THAT THE COMPANY IS REQUESTING TO RECOVER EXCEED THE AMOUNT THAT IS REQUIRED TO PROVIDE MARKET-COMPETITIVE COMPENSATION TO EMPLOYEES?

A. No. As Exhibits ARC-3 through ARC-6 show, the target STI and LTI compensation components of total compensation are not a 'bonus' that provides compensation in excess of market-competitive total compensation. Rather, such Incentive Compensation is a critical element of a reasonable, necessary, and prudent market-competitive total compensation package.

The compensation analyses contained in Exhibits ARC-3 through ARC-6 also shows that incentive compensation is extraordinarily prevalent in the labor market for the Companies' positions. Market median Total Compensation includes incentive compensation for 100 percent of the 318 positions and 3,380 incumbent employees included in the market compensation analyses shown in Exhibits ARC-3 through ARC-6.

Q. ARE BOTH BASE PAY AND INCENTIVE COMPENSATION PART OF AN OVERALL REASONABLE LEVEL OF TOTAL COMPENSATION?

A. Yes. As shown for each group of employees in the preceding questions, the Total Compensation for many of the Companies' positions would not be market-competitive without the expense associated with the target level of both STI and LTI compensation.

VI. THE BENEFITS OF INCENTIVE COMPENSATION

Q. WHAT ARE THE BENEFITS TO AEP OHIO'S CUSTOMERS OF THE COMPANIES' INCENTIVE COMPENSATION?

A. First and foremost, the Companies' STI and LTI compensation benefit customers by enabling the Companies to attract and retain the suitably skilled and experienced employees needed to provide service to customers efficiently, effectively and safely. The ability to attract and retain such a workforce is, quite simply, essential to meeting customers' needs at a reasonable cost. Without the compensation opportunity that the Companies' Incentive Compensation provides, as shown in Exhibits ARC-3 through ARC-6, the Total Compensation for many positions would be below the market-competitive range, which would impair the Companies' ability to attract and retain such employees, increase employee turnover, and reduce employee engagement. This, in turn, would increase hiring and training costs, reduce productivity, result in declining service levels, and increase the cost of service for customers.

Because the Companies' Incentive Compensation is a component of a reasonable and market-competitive Total Compensation package (*i.e.*, within the market-competitive range), it has no incremental cost above the cost of providing market-competitive compensation through Base Pay alone.

Incentive Compensation also helps maintain higher levels of employee and company performance than would be achieved with Base Pay alone. It does this by linking a portion of employees' total compensation opportunity to performance without increasing the total compensation expense.

Q. HOW DOES INCENTIVE COMPENSATION IMPROVE EMPLOYEE AND COMPANY PERFORMANCE?

A. Incentive compensation improves employees' and the Companies' performance by more effectively communicating goals and objectives, better aligning employee efforts with these goals and objectives, more effectively engaging employees, and motivating employees to achieve higher levels of performance. Specifically, incentive compensation helps create a culture of high performance by:

- Giving all employees a personal stake in achieving common goals and objectives, which creates a sense of shared purpose and improves employee engagement;
- Communicating goals and objectives to all managers and employees more effectively than is otherwise possible, which helps align and focus work assignments and employee efforts with these objectives;
- Encouraging and motivating employees to expend discretionary effort to achieve these goals and objectives;
- Varying compensation based on individual employee performance, which recognizes and appropriately adjusts rewards for both strong and poor employee performance, improves employee engagement, and encourages performance improvement;
- Rewarding employees for achievement of the Companies' goals and objectives, which reinforces the importance of these goals and objectives, recognizes both high and low performance, and improves employee engagement;
- Shifting a portion of compensation from a fixed expense to variable expense, which reduces business risk by linking a portion of labor expense to the Companies' financial performance; and

- Encouraging high levels of productivity and fostering careful cost management.

These specific benefits of incentive compensation significantly reduce the cost of service for AEP Ohio customers below what they would be otherwise.

Q. DO THE GAINS PRODUCED BY INCENTIVE COMPENSATION RESULT IN AN ACCUMULATION OF BENEFITS AND COST SAVINGS THAT ACCRUE TO AEP OHIO CUSTOMERS EACH YEAR?

A. Yes. The Companies have had both STI and LTI compensation programs for more than two decades, and these incentive compensation programs have produced benefits that inured to AEP Ohio customers in rate cases over these many years. These benefits are generally the result of the high performance culture that the Companies' incentive compensation helps encourage. The accumulated value that has been produced over the more than two decades these programs have been in place is reflected in the Companies' cost of service in the test years for prior base rate cases as well as in this case. The decades of accumulated value produced by Incentive Compensation has inured to customers through lower rates in prior rate proceedings and any additional value it has created since the last base rate case will again inure to customers when rates are established in this case. These benefits gradually accumulated over time and are likely to diminish over time if incentive compensation were eliminated. Such 'back-sliding' would be detrimental to AEP Ohio customers.

Q. SHOULD IT BE EXPECTED THAT THE INCREMENTAL PRODUCTIVITY BENEFITS AND COST SAVINGS GENERATED BY INCENTIVE COMPENSATION WILL EXCEED ITS TOTAL (INCREMENTAL AND NON-INCREMENTAL) COST?

A. No. Although the Companies' Incentive Compensation provides substantial benefits, as I just described, it is unreasonable to expect that the new incremental productivity benefits and cost savings generated each year will offset its non-incremental cost. This is because the Companies' Incentive Compensation is a component of a reasonable and market-competitive Total Compensation program, rather than a 'bonus' that is additional to such a program. Therefore, the Companies' Incentive Compensation has no incremental cost to offset, and it produces the substantial incremental benefits previously described at no incremental expense to customers. Furthermore, the Companies' Incentive Compensation has been in place for more than two decades and maintaining it prevents gradual backsliding on its accumulated benefits over these years.

As has been shown, the target level of the Companies' Incentive Compensation provides substantial benefits to customers at no incremental cost above the cost of providing market-competitive Total Compensation through Base Pay alone. Therefore, the related expense is a just, prudent, reasonable, and customary cost of doing business. Customers already benefit from the accumulated value that Incentive Compensation has provided over the decades it has been in place, and, given that there is no reasonable expectation that it will produce additional benefits sufficient to offset its cost going forward, it is clear that customers are the primary beneficiaries of the Companies' Incentive Compensation. It would be highly inappropriate and unsustainable for shareholders to bear a large portion of the cost of the target level of Incentive Compensation, as well as 100% of any above target expense, while customers receive 100% of the benefits Incentive Compensation has created over the decades it has been in place.

VII. SHORT-TERM INCENTIVE COMPENSATION

Q. HOW COMMON IS STI COMPENSATION?

A. STI is a nearly universal component of Total Compensation for employees at all levels in the energy services industry and among U.S. industry in general. The lowest paid positions in the energy services industry, those with annual Base Pay of less than $30,000, have a target annual STI opportunity of 5 percent of salary at the median and 4 percent at the 25th percentile.[3] STI compensation becomes even more prevalent and a larger component of Total Compensation for higher paid positions. The median target STI opportunity for employees with base salaries of greater than $200,000 is 25 percent of salary for the positions in this survey.[4] Over 148 energy services industry companies participated in this survey, which includes short-term incentive compensation information for over 240,000 incumbents.[5] STI compensation is similarly pervasive and similarly significant as a component of the Total Compensation for U.S. general industry.

Q. DOES STI COMPENSATION PROVIDE ADDITIONAL SPECIFIC BENEFITS?

A. Yes. The Companies' STI compensation plans include goals that encourage safety, environmental stewardship, reliability compliance, budget achievement, infrastructure investment, renewable generation growth, improved reliability, high customer satisfaction,

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[3] Willis Towers Watson, 2019 Energy Services Middle Management, Professional and Support Compensation Survey –U.S., Short-Term Incentive Analysis, p. 7.
[4] Id.
[5] Id., Participant Overview, p. 2.

employee engagement, supplier and workforce diversity, technology innovation, development of a Line Mechanic recruitment pipeline, outage restoration process improvement, and timely completion of reliability and strategic work plans. These objectives align well with the interests of AEP Ohio customers and the communities AEP Ohio serves.

Q. PLEASE DESCRIBE THE COMPANIES' STI PLANS.

A. The Companies' STI plans cover all the Companies' employees from hourly positions through executive management, except co-ops and interns. The Companies use a standard approach and template for annual incentive compensation plans with separate plan documents, performance measures, and communications for employees in each major AEP business unit and operating company. The overall performance measure score for each AEP business unit and operating company, including AEP Ohio, determines the award payout for that group from the available funding. Overall performance scores and award payouts can range from 0 percent to 200 percent of the target. Employees in centralized functions, such as IT, human resources, and legal, do not have separate STI performance measures and participate in STI compensation based on the average overall performance score for the business units and operating companies that do have separate STI performance measures.

STI targets vary by salary grade level for most positions. For example, physical, craft, and technical positions have STI targets of 5 percent of eligible earnings, which includes base wages, overtime, and shift premiums. The Companies establish STI targets for each salary grade to provide Total Compensation within the market-competitive range and close to the market median on average for the positions assigned to each grade level, assuming target performance and payouts. This approach is typical for U.S. industrial companies.

The Companies establish performance targets for STI measures at stretch but achievable levels to ensure that employees have a reasonable expectation that STI will pay out at or above the target level on average over multiple years. This expectation is foundational because, without it, many employees would not perceive their Total Compensation opportunity to be market-competitive and employee attrition would be likely to increase to problematic levels. However, the Companies clearly communicate, and most participants understand, that STI compensation is variable and may vary both above and below target from year to year but can reasonably be expected to meet or exceed a target level on average over longer-term periods. The Companies' STI has averaged 154% of target over the last 5 years, which is well above the target level. It is the target level of STI that brings the Companies' target Total Compensation to reasonable and market-competitive levels and that the AEP Ohio has requested be included in its cost of service in this case.

Q. PLEASE DESCRIBE HOW THE COMPANIES' STI COMPENSATION PLANS ARE FUNDED.

A. The overall funding available for AEP's total 2020 STI program is based on AEP's Operating Earnings Per Share. A balanced scorecard of operating objectives may also be used to make discretionary adjustments to 2020 STI funding. This balanced scorecard includes Safety and Compliance (25 percent), Infrastructure Investment (37.5 percent), Customer Experience and Quality of Service (25 percent), and Workforce of the Future and Culture (12.5 percent).[6]

Q. WHAT IS THE PURPOSE OF THE FUNDING MECHANISM FOR ANNUAL INCENTIVE COMPENSATION?

A. The funding mechanism is necessary to ensure that the sum of the STI awards produced by the overall business unit and operating company STI performance scores is commensurate with the Companies' overall performance. This funding mechanism also facilitates business unit and operating company goal setting by shifting the emphasis from establishing stretch but achievable performance targets to ensuring a consistent degree of difficulty among AEP's business units and operating companies.

The funding mechanism also ensures the Companies can afford employee incentive compensation while also meeting their commitments to other stakeholders and that STI compensation does not impair the Companies financially. The importance of a mechanism to ensure that incentive funding is commensurate with a utility company's financial circumstances became apparent with the elimination of incentive compensation for PG&E employees due to that company's bankruptcy, a decision with which the California Consumer Counsel agreed. Anyone who has ever managed their living expenses within a budget knows that it is not sustainable and can be detrimental to their financial health to spend more than they can afford.

Tying STI funding to the Companies' financial performance also sends a clear message to participants that it is imperative for them to maintain financial discipline. This,

[6] The weights shown reflect the 2020 plan year.

in turn, enables the Companies to complete work at a lower cost than would otherwise be the case.

Q. PLEASE DESCRIBE HOW STI COMPENSATION FUNDS ARE ALLOCATED.

A. Each AEP operating company and business unit has a separate set of STI performance measures for STI compensation purposes. Each operating company's and business unit's overall STI score is determined by its performance against its STI performance measures relative to the weighted average performance of all operating companies and business units. This relative performance determines each group's STI funding allocation from AEP's total STI funding. This is accomplished by normalizing the overall business unit and operating company scores, which simply means that each such score is divided by the weighted average of all such scores. This results in a normalized average score of 1.0 or 100% of the target level. Each business unit and operating company score is then multiplied by the funding score, which results in a normalized and weighted average score for AEP as a whole that is equal to the funding score. This process results in scores and payouts for each business unit and operating company that reflect the group's performance and a total payout that is equal to the overall funding available.

Q. WHAT ARE THE KEY DRIVERS OF STI COMPENSATION FOR AEP OHIO EMPLOYEES?

A. AEP Ohio performance as measured against defined operational objectives are the key performance objectives that drive STI compensation for AEP Ohio employees. Operational measures in three categories (operational excellence, customer, and workforce development) comprise 80% of the 2020 performance measures for AEP Ohio, while financial performance (AEP Ohio net income) makes up the remaining 20%.

The heavy emphasis on operational performance in determining awards paid to employees strongly reflects the importance placed on customer interests. If AEP Ohio employees do not achieve their operational performance objectives, they will not be paid a significant STI award, irrespective of AEP's or AEP Ohio's financial performance.

Q. PLEASE DESCRIBE THE 2020 PERFORMANCE MEASURES THAT ARE INCLUDED IN THE STI PLAN FOR AEP OHIO DISTRIBUTION EMPLOYEES.

A. Most AEP Ohio employees participate in the AEP Utilities 2020 ICP (incentive compensation plan) for AEP Ohio distribution employees. This plan included 12 performance measures in four categories (see Exhibit ARC-7).

AEP Ohio employees also participate in the 2020 STI plans for centralized staff (175), T&D Performance Management (62), and Generation - Environmental Services (3) groups. The centralized staff group ICP is based on the average score for all business units and operating companies.

Q. WHAT ARE THE BENEFITS TO CUSTOMERS FROM THE WORKFORCE DEVELOPMENT MEASURES IN THE STI PROGRAM?

A. The workforce development category includes safety, employee culture, diversity, and a line mechanic pipeline development performance measures. First, with respect to the safety measures, it is important to acknowledge that the cost of severe safety incidents to an individual and their families, friends, colleagues, and community is often immeasurable and outweighs the financial cost to the Company and its customers. Such societal costs are paramount in any evaluation of the cost of improving safety from a public policy perspective. With this said, the DART (**D**ays **A**way, **R**estricted Duty and **T**ransfer) rate and proactive safety measures included in the Companies' STI programs benefits customers by promoting safe work practices, reducing the number of recordable injuries, reducing serious injuries, reducing lost work days, reducing workers compensation costs, and reducing employee medical claims. The proactive safety measures encourage the involvement of employees at all levels in activities that help identify and mitigate safety risks. These measures foster a safety culture that is critical to reducing safety incidents. The Company's safety statistics have improved substantially over the many years the Companies' have had safety incentive measures, which we believe is the result of the Companies' safety culture, including its safety incentives.

The employee diversity measure benefits customers by, among other things, providing a broader prospective and better engagement with the communities AEP Ohio serves and by fostering better employee inclusivity, engagement, and performance. This improves customer service and reduces the cost of serving customers.

The accountability index measure helps create a culture where employees are more engaged in their work, feel appreciated and valued, and have a sense of ownership and accountability. Improving employee engagement has been shown to improve employee and company performance, which benefits customers by accomplishing more work with less resources, the savings from which are passed on to customers in rate case proceedings.

The line mechanic recruitment model measure benefits customers by leveraging line mechanic training colleges to create a pipeline for C100 certified candidates to fill AEP Ohio line mechanic positions. C100 line mechanics need substantially less apprenticeship and training than entry-level line mechanics, which saves customers the cost of providing such training, and C100 level line mechanics can safely contribute immediately on some types of work, which is not the case for entry-level line mechanics.

C100 line mechanics from training colleges are also more likely to progress to the journey level. All of this reduces hiring, training, and turnover related expenses for AEP Ohio customers.

Q. WHAT ARE THE BENEFITS TO CUSTOMERS FROM THE CUSTOMER MEASURES IN THE STI COMPENSATION PROGRAM?

A. The JD Power – Power Quality & Reliability (PQR) and Power Communications measures benefit customers by improving these aspects of customer service, which are important to AEP Ohio customers. The CMI improvement measure benefits customers by improving the outage restoration process, which will help alleviate one of the largest sources of customer frustration. These measures benefit customers by improving customer service in ways that are important to customers.

Q. WHAT ARE THE BENEFITS TO CUSTOMERS FROM THE OPERATIONAL EXCELLENCE MEASURES IN THE STI COMPENSATION PROGRAM?

A. As with the customer satisfaction measures above, the SAIDI[7] and reliability work plan measures benefit customers by encouraging actions that reduce outage frequency and duration, improve response and restoration times, and make system improvements that have these same benefits. For example, the reliability work plan measures include removing trees outside the rights-of-ways that could cause outages, utilizing mobile generators to reduce station related planned outages, deploying 500 sensors to improve operational decision making and implementing an asset rehabilitation program. Obviously,

[7] (SAIDI) System Average Interruption Duration Index represents the total number of minutes the average customer has experienced interruption over a 12 month period.

reducing the frequency and duration of outages provides substantial tangible and intangible benefits to customers.

The Strategic Operational Excellence Work Plan measures benefit customers by encouraging the development of rural broadband services, electric vehicle rates, and gridSMART Programs. These measures improve AEP Ohio's service offerings and reduce costs for customers.

Q. WHAT ARE THE BENEFITS TO CUSTOMERS OF THE FINANCIAL MEASURES IN THE STI COMPENSATION PROGRAM?

A. The financial STI performance measures focus employees on cost control, adherence to budget, and promoting the efficient use of financial resources, which is essential for providing reliable service at a reasonable cost to customers. Financial measures continuously emphasize the importance of maintaining financial discipline and directly encourage employees to spend conservatively, operate efficiently, and conserve resources. This has and will continue to directly benefit customers by reducing the Company's cost of service through cost savings that are passed on to customers in rates that are lower than they otherwise would be if AEP Ohio did not use such performance measures.

Financially-based incentive compensation is also a mechanism for reducing the Company's cost of capital and better ensuring access to capital at reasonable rates, particularly during recessionary and other periods of weaker earnings, such as those caused by major storms or catastrophic events. This provides additional capital, reduces earnings volatility, and bolsters the Company's financial stability, which provides access to capital at more reasonable rates when capital may otherwise be overly expensive or inaccessible. Furthermore ensuring that incentive compensation payments do not impair the Company financially reduces the risk of additional expense caused by difficulties, which benefits AEP Ohio customers. These effects all reduce the cost of service for AEP Ohio customers.

Q. IS THE COMPANY REQUESTING THE INCLUSION OF ALL TEST YEAR STI COMPENSATION IN ITS REVENUE REQUIREMENT IN THIS CASE?

A. No. The Company is requesting that only the expense for the target level of test year STI compensation be included in its cost of service for rate making purposes, which is the market-competitive level, rather than the larger actual per books expense. Customers are receiving and will continue to receive benefits from the suitably skilled and experienced employees who were attracted, retained, and engaged from the larger actual level of STI compensation awarded, as well as from the accumulated value of incentivized achievements over the many years the STI program has been in place.

Q. PLEASE SUMMARIZE YOUR TESTIMONY WITH RESPECT TO STI COMPENSATION.

A. The Companies' annual incentive program provides substantial benefits to customers and has no direct or indirect cost above the cost of providing market-competitive Total Compensation through Base Pay alone. It would be unfair and unjust to exclude incentive compensation from rates and would not be a sustainable or defensible approach to ratemaking. Therefore, it is just and reasonable to include the full cost of the target level of incentive compensation in the Company's cost of service.

VIII. <u>LONG-TERM INCENTIVE COMPENSATION</u>

Q. IS THE COMPANY REQUESTING THAT LTI COMPENSATION EXPENSE BE INCLUDED IN ITS COST OF SERVICE IN THIS CASE?

A. Yes. LTI is similar to STI, except that it is tied to performance and employee retention over a longer period. The Company is requesting that the test year level of LTI compensation be included in the Company's cost of service.

Q. PLEASE EXPLAIN THE COMPANY'S LTI COMPENSATION PROGRAM.

A. As with STI, the primary objective of the Company's LTI program is to provide the reasonable and market-competitive compensation necessary, as part of a Total Compensation package, to attract, retain, and engage suitably skilled, experienced, and knowledgeable employees. LTI also encourages decision making from a long-term perspective and fosters operational continuity by improving the long-term retention of participants.

Approximately 1,300 employees (about 7% of AEP employees) will receive an LTI award in the test year. Participation is generally limited to employees in positions that have responsibility for decisions that have a longer-term impact on the Companies and customers. Such employees often have historical and experiential knowledge of the Companies' practices and often assist in creating and implementing the vision of how AEP and AEP Ohio best serve customers both now and in the future. LTI participants are often responsible for maintaining the focus of employees on customers, making often-difficult allocation of resource decisions, and driving customer experience improvements. Because of the value these employees provide to the Companies and customers, retaining them is particularly important to providing high quality service to customers at a reasonable cost. The Companies designed the LTI compensation program to foster the retention of such participants.

As with STI, the Companies provide LTI compensation as part of a reasonable and market-competitive Total Compensation opportunity that has no incremental cost above the cost of providing market-competitive Total Compensation through Base Pay alone.

LTI awards granted in the test year were composed of 75 percent performance units and 25 percent restricted stock units (RSUs).

Q. PLEASE DESCRIBE PERFORMANCE UNITS.

A. Performance units are generally similar in value to shares of AEP common stock, except that participants must generally continue their AEP employment over a three-year period to earn a payout and the number of performance units that participants ultimately earn is tied to AEP's long-term performance. All performance units granted in 2020 were granted with three performance measures:

- Three-year cumulative operating earnings per share (Operating EPS) measured relative to a Board-approved target (50% weight),
- Three-year total shareholder return (TSR) measured relative to a peer group of similar utility companies (40% weight), and
- Non-Emitting Generation Capacity measured relative to a board approved target (10% weight).

Awards granted prior to 2020 had two performance measures, Operating EPS and TSR, (both as described above), which were equally weighted. As with STI, the Companies' cap the maximum score for all LTI performance measures at 200% of target. Taken together, the STI and LTI measures balance the short-term and long-term interests of the Companies' and its customers.

Q. PLEASE DESCRIBE RESTRICTED STOCK UNITS.

A. The Companies provide the remaining 25% of its LTI in the form of RSUs that vest subject to the participants' continued AEP employment over a three-year or more vesting period.

RSUs and are not tied to any performance measures. Participants who remain continuously employed with AEP through a vesting date receive an equal number of shares of AEP common stock as the number of vesting RSUs.

Q. WHAT LEVEL OF LTI COMPENSATION IS THE COMPANY REQUESTING IN THIS CASE?

A. The Company is requesting that the test year actual amount of LTI be included in the Company's cost of service. As with annual incentive compensation, customers are receiving and will continue to receive benefits from the suitably skilled and experienced employees who were attracted, retained, and engaged from the larger level of LTI expense awarded in past years as well as from the accumulated value of incentivized achievements over the many years the LTI program has been in place.

Q. IS LONG-TERM INCENTIVE COMPENSATION A PREVALENT FORM OF COMPENSATION FOR THE UTILITY INDUSTRY?

A. Yes, it is highly prevalent. Nearly all investor owned utility companies of AEP's size and complexity have similar long-term incentive programs, as do nearly all public general industry companies. Long-term incentive compensation is a significant component of total compensation (19 percent of base salary at a minimum) for all 136 unique positions for which a sufficient sample was available.[8] Exhibit ARC-6 shows that long-term incentive compensation is a substantial component of market-competitive compensation for all of the positions included in this analysis.

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[8] Willis Towers Watson. 2019 Energy Services Executive Compensation Survey - U.S. Report, Position Listing, incumbent weighted statistics.

Q. WHAT ARE THE BENEFITS TO CUSTOMERS FROM THE COMPANIES' LTI COMPENSATION PROGRAM?

A. In addition to the benefits that all of the Companies' Incentive Compensation provides to customers, LTI compensation also provides a retention incentive to participants, which benefits customer by improving the retention of employees with greater company experience in roles that have long-term decision-making responsibility, which improves the continuity of the Companies' operations.

The non-emitting generation capacity measure benefits customers and the communities the Companies serve by encouraging, over a longer-term period, the addition of regulated and competitive renewable generation to the grid, retirement of greenhouse gas emitting plants, and increased use of energy efficiency and demand-side management programs. This has the added benefit of improving perceptions of the Companies in the eyes of the customers, the public, investors, and potential recruits, all of which may lead to reduced costs for customers as the result of improved customer interactions and increased interest from investors and potential recruits that this provides.

Tying a portion of management compensation to long-term measures of financial performance, specifically the EPS and TSR measures used in the Companies' performance unit awards, encourages better long-term decision making and financial discipline, which benefits customers by encouraging cost control. Customers benefit from efficient, effective, and consistent operations; suitably skilled, experienced, knowledgeable, and stable employees in management and other leadership positions; better long-term decision-making; and strong financial discipline. All of these factors contribute to lower costs for customers.

Maintaining long-term financial discipline is imperative, particularly given the long-term nature of the assets that comprise the Company's electric system. The EPS and TSR performance unit measures communicate this imperative and strongly encourage its pursuit, which promotes expense control, efficient operations, and conservation of resources. This directly benefits customers by reducing the Company's cost of service and rates compared to what they would otherwise be.

Q. ARE THERE ANY INDIRECT COSTS TO CUSTOMERS OF THE COMPANIES' LTI PROGRAM?

A. No. Capping the maximum score, setting stretch but achievable targets, and providing a balance of short-term and long-term incentive compensation, as the Companies do, ensures that participants are not encouraged to pursue a few objectives at the expense of other important objectives, such as customer service and safety. The Companies' short-term and long-term performance measures are designed to balance each other to ensure that short-term objectives are not achieved at the expense of long-term performance. Likewise, the Companies' financial short and long-term performance objectives are balanced by operational and other objectives as part of a "balanced scorecard" to better assure that financial objectives are not achieved at the expense of other important objectives. This balanced approach mitigates the potential for the Companies' LTI compensation to encourage behaviors that would be counter to customers' interests. Therefore, LTI compensation does not give rise to any indirect costs that would offset the substantial benefits it provides to customers.

Q. DO THE TOTAL BENEFITS OF THE LTI COMPENSATION EXCEED ITS COST TO AEP OHIO CUSTOMERS?

A. Yes. By providing LTI compensation as part of a market-competitive total direct compensation package, LTI compensation does not have any incremental cost to customers, beyond the cost of providing market-competitive Total Compensation through other types of compensation. By encouraging participant retention, which improves operational continuity and performance, it reduces the cost of service for customers. It also reduces the cost customers bear by encouraging long-term financial discipline, among the other benefits previously mentioned. With significant accumulated benefits, new incremental benefits, and no incremental cost, the benefits of the LTI program clearly exceed its cost to customers.

Q. IS IT REASONABLE AND NECESSARY TO INCLUDE LTI COMPENSATION IN THE COMPANIES' COST OF SERVICE FOR RATE MAKING PURPOSES?

A. Yes. LTI compensation has been clearly shown to be a reasonable, customary, and prudent cost of doing business that provides substantial overall net benefit to customers because, among other reasons, it:

(a) Does not have any incremental cost above the cost of providing market-competitive compensation through other forms of pay;

(b) Improves participant retention and, consequently, management and operational continuity;

(c) Encourages appropriate consideration of longer-term factors in decision making; and

(d) Improves operating effectiveness and cost control.

Therefore, it is just and reasonable to include the cost of LTI compensation in AEP Ohio's cost of service for ratemaking purposes.

IX. SUMMARY

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. The Companies must offer employees a market-competitive Total Compensation opportunity in order to attract and retain the suitably skilled and experienced workforce necessary to provide service to customers efficiently, effectively and safely. Providing a market-competitive level of compensation is beneficial to AEP Ohio customers. The Companies' STI and LTI compensation programs do not have any incremental cost to AEP Ohio customers above the cost of providing market-competitive Total Compensation through Base Pay alone and these programs provide substantial benefits to customers, such as by reducing cost and improving customer service. Furthermore, because these compensation programs have been in place for many years, the accumulated and ongoing benefits of these programs have been reflected in the Companies cost of service in many prior rate case proceedings, as they will again be reflected in the cost of service and rates in this proceeding. It would be unreasonable and unjust for the Companies' shareholders to bear a large portion of the requested value of such incentive compensation while customers enjoy the entire accumulated and ongoing benefits of the far larger actual cost.

Therefore, the compensation included in the Company's requested cost of service in this case, including the STI and LTI compensation components, is a reasonable, necessary, customary and prudently incurred cost of doing business that provides substantial benefits to customers. The requested amount of STI and LTI compensation, therefore, should be approved and included in the Company's cost of service.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Surveys Completed and Used for Compensation Comparisons

<u>Willis Towers Watson U.S. Compensation Data Bank (CDB):</u>

2019 Energy Services Industry - Executive Compensation Survey Report

2019 Energy Services Industry - Middle Management, Professional & Support Compensation Survey Report

2019 General Industry - Executive Compensation Survey Report

2019 General Industry - Middle Management, Professional and Support Compensation Survey Report

2018 Energy Marketing and Trading Survey Report

2019 Custom AEP Peer Group - Executive Compensation Surveys

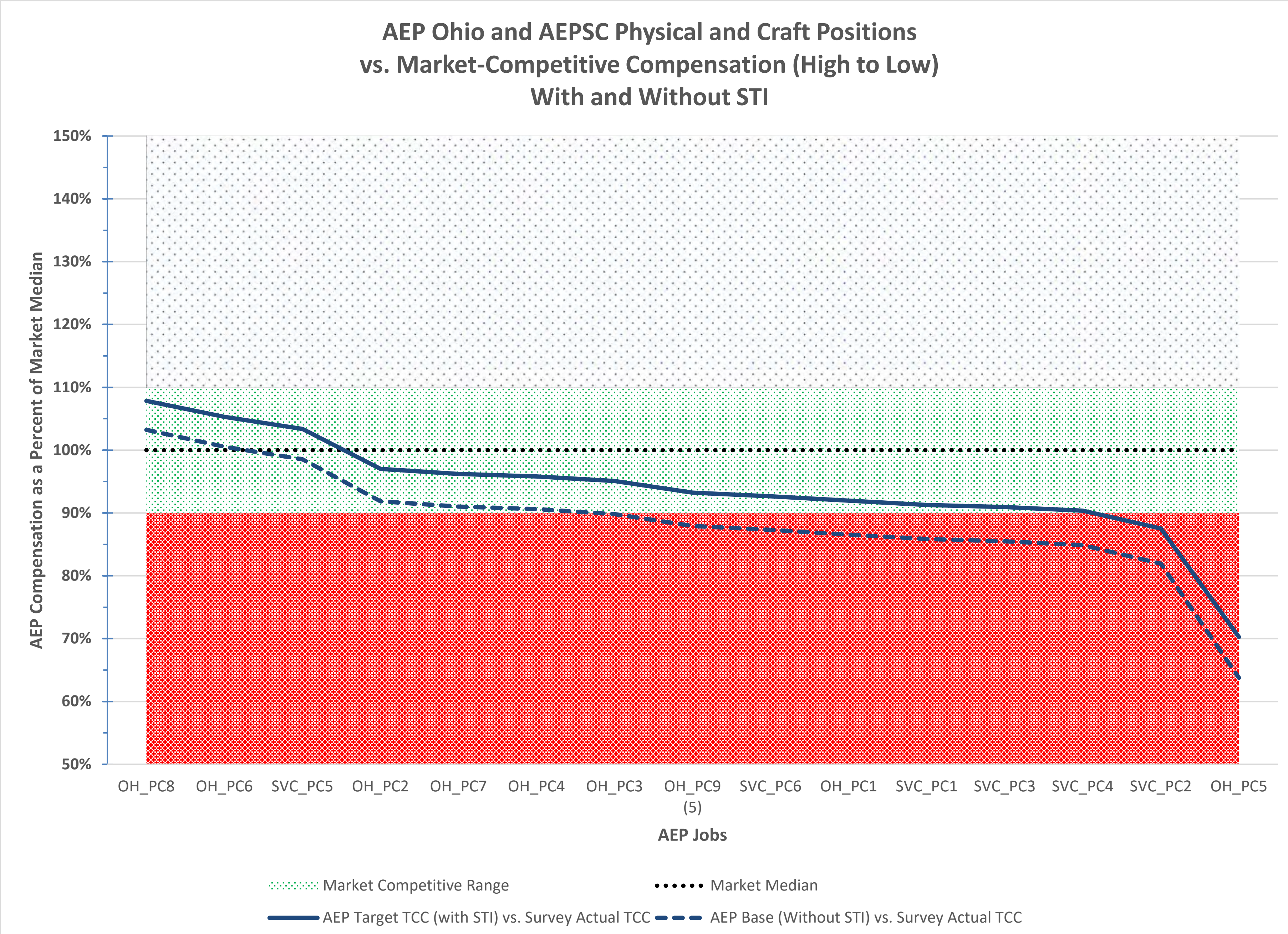
2019 Custom AEP Broad Peer Group - Executive Compensation Surveys

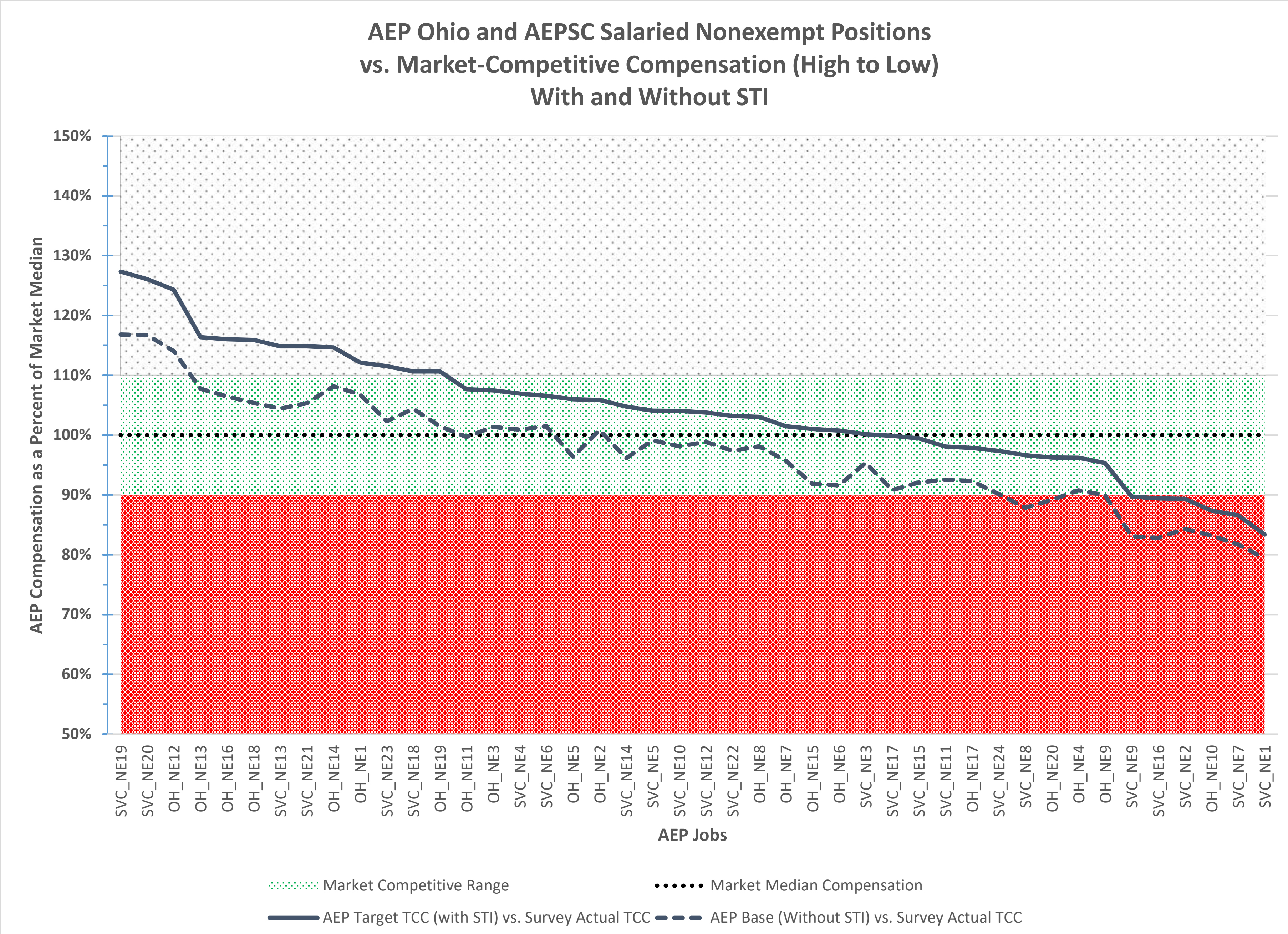
EAPDIS, LLC - 2019 Energy Technical Craft Clerical Survey

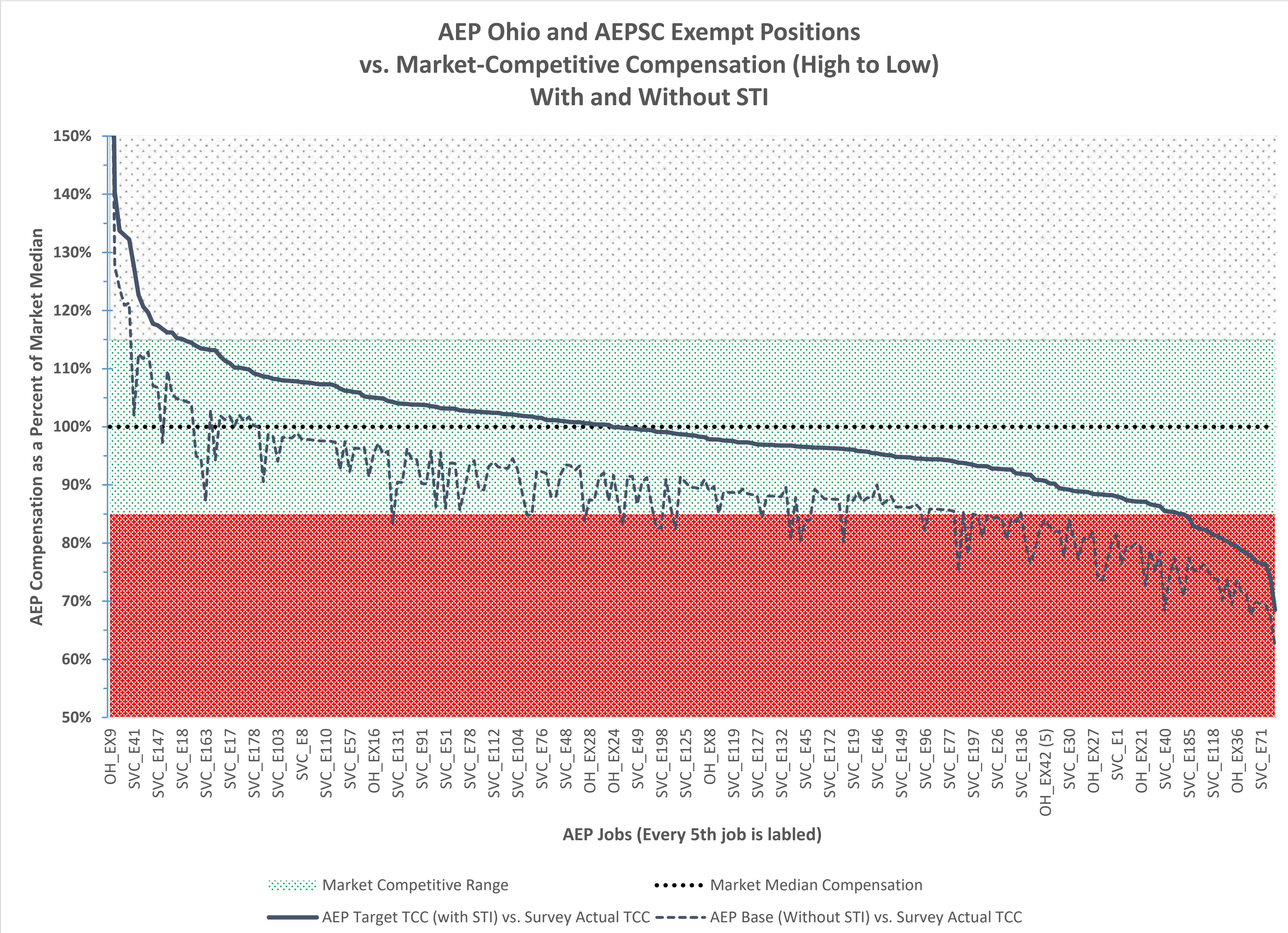
Equilar Top 25 Survey - 2018 TrueView Survey Report

Company Witness Andrew R. Carlin has submitted rate case testimony in the following regulatory proceedings:

- To the Oklahoma Corporation Commission on behalf of Public Service Company of Oklahoma in Cause Nos. 201000050, 201300217, 201500208 and 201700151.
- To the Michigan Public Service Commission on behalf of Indiana Michigan Power in Case Nos. U-16180, U-16801 and U-18370.
- To the Indiana Utility Regulatory Commission on behalf of Indiana Michigan Power in Cause No. 44967 and 45235.
- To the West Virginia Public Service Commission on behalf of Appalachian Power Company and Wheeling Power Company in Case No. 10-0699-E-42T and 14-1152-42T.
- To the Virginia State Corporation Commission on behalf of Appalachian Power Company in Case No. PUE-2011-00037.
- To the Kentucky Public Service Commission on behalf of Kentucky Power Company in Case Number 2009-00459, 2013-00197, 2014-00396 and 2017-00179.
- To the Texas Public Utility Commission on behalf of AEP Texas Inc. and for AEP Texas Central Division (Central Division) and AEP Texas North Division (North Division) PUC Docket Number 49494.
- To the Texas Public Utility Commission on behalf of Southwestern Electric Power Company in Dockets No. 40443 and 46449.
- To the Arkansas Public Service Commission on behalf of Southwestern Electric Power Company in Docket No. 19-008-U.


AEP Ohio and AEPSC Physical and Craft Positions
vs. Market-Competitive Compensation (High to Low)
With and Without STI
AEP Compensation as a Percent of Market Median
150%
140%
130%
120%
110%
100%
90%
80%
70%
60%
50%
OH_PC8
OH_PC6
SVC_PC5
OH_PC2
OH_PC7
OH_PC4
OH_PC3
OH_PC9 (5)
SVC_PC6
OH_PC1
SVC_PC1
SVC_PC3
SVC_PC4
SVC_PC2
OH_PC5
AEP Jobs
Market Competitive Range
Market Median
AEP Target TCC (with STI) vs. Survey Actual TCC
AEP Base (Without STI) vs. Survey Actual TCC


AEP Ohio and AEPSC Salaried Nonexempt Positions
vs. Market-Competitive Compensation (High to Low)
With and Without STI
AEP Compensation as a Percent of Market Median
150%
140%
130%
120%
110%
100%
90%
80%
70%
60%
50%
SVC_NE19
SVC_NE20
OH_NE12
OH_NE13
OH_NE16
OH_NE18
SVC_NE13
SVC_NE21
OH_NE14
OH_NE1
SVC_NE23
SVC_NE18
OH_NE19
OH_NE11
OH_NE3
SVC_NE4
SVC_NE6
OH_NE5
OH_NE2
SVC_NE14
SVC_NE5
SVC_NE10
SVC_NE12
SVC_NE22
OH_NE8
OH_NE7
OH_NE15
OH_NE6
SVC_NE3
SVC_NE17
SVC_NE15
SVC_NE11
OH_NE17
SVC_NE24
SVC_NE8
OH_NE20
OH_NE4
OH_NE9
SVC_NE9
SVC_NE16
SVC_NE2
OH_NE10
SVC_NE7
SVC_NE1
AEP Jobs
Market Competitive Range
Market Median Compensation
AEP Target TCC (with STI) vs. Survey Actual TCC
AEP Base (Without STI) vs. Survey Actual TCC


AEP Ohio and AEPSC Exempt Positions
vs. Market-Competitive Compensation (High to Low)
With and Without STI
AEP Compensation as a Percent of Market Median
150%
140%
130%
120%
110%
100%
90%
80%
70%
60%
50%
OH_EX9
SVC_E41
SVC_E147
SVC_E18
SVC_E163
SVC_E17
SVC_E178
SVC_E103
SVC_E8
SVC_E110
SVC_E57
OH_EX16
SVC_E131
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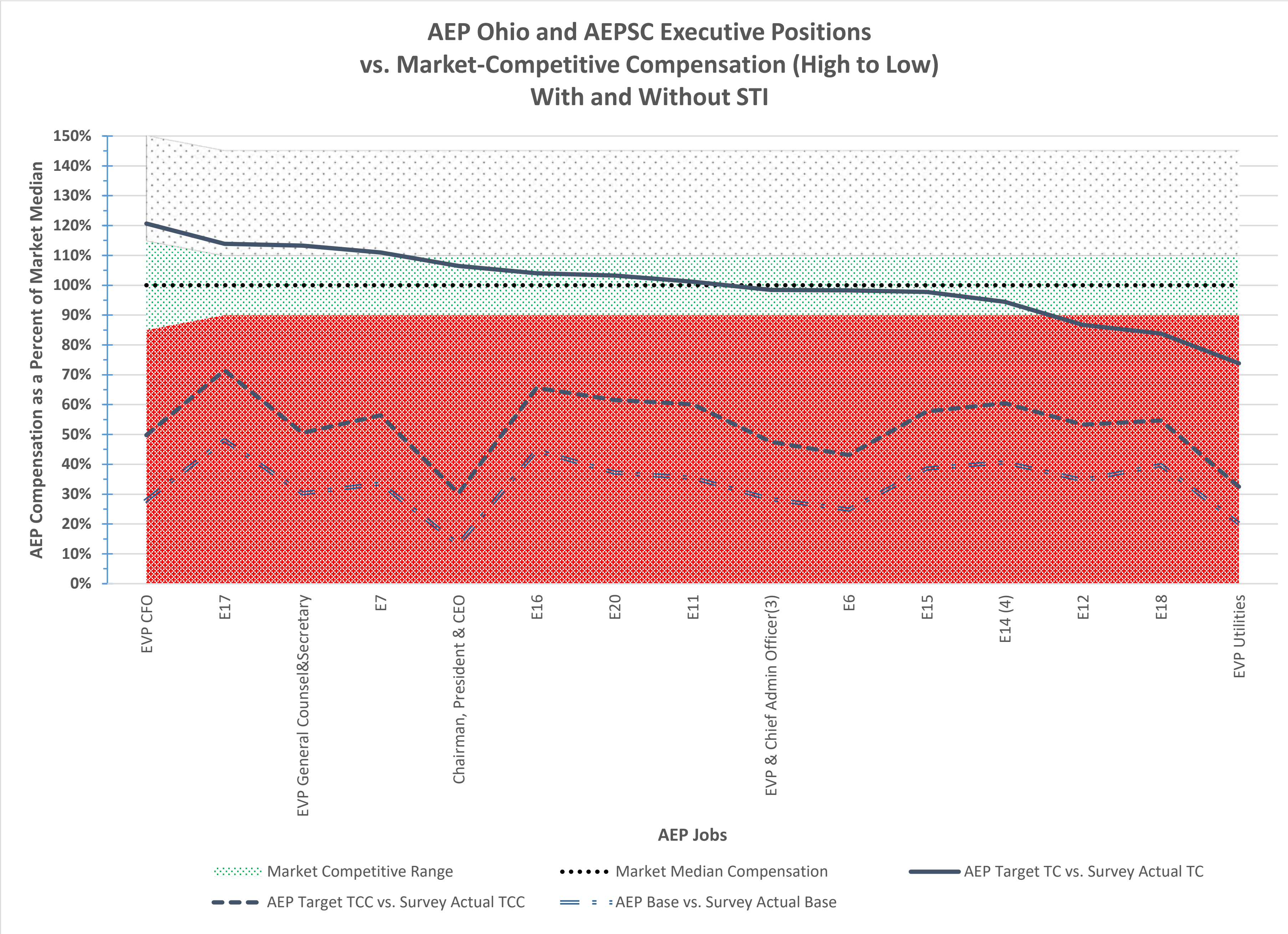
SVC_E96
SVC_E77
SVC_E197
SVC_E26
SVC_E136
OH_EX42 (5)
SVC_E30
OH_EX27
SVC_E1
OH_EX21
SVC_E40
SVC_E185
SVC_E118
OH_EX36
SVC_E71
AEP Jobs (Every 5th job is labled)
Market Competitive Range
Market Median Compensation
AEP Target TCC (with STI) vs. Survey Actual TCC
AEP Base (Without STI) vs. Survey Actual TCC


AEP Ohio and AEPSC Executive Positions
vs. Market-Competitive Compensation (High to Low)
With and Without STI
AEP Compensation as a Percent of Market Median
150%
140%
130%
120%
110%
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
EVP CFO
E17
EVP General Counsel&Secretary
E7
Chairman, President & CEO
E16
E20
E11
EVP & Chief Admin Officer(3)
E6
E15
E14 (4)
E12
E18
EVP Utilities
AEP Jobs
Market Competitive Range
Market Median Compensation
AEP Target TC vs. Survey Actual TC
AEP Target TCC vs. Survey Actual TCC
AEP Base vs. Survey Actual Base

******AEP Utilities 2020 ICP Plan ******

	Metric Name	Brief Description	Measures and Targets	Metric Weighting (%)
Workforce Development 35%	**DART Rate - Employee & Contractor**	DART (Days away, restricted or transferred) safety metric for both AEP employees and contractors	TBD - From Corporate Safety	5.0%
	Proactive Safety Performance	Collaborating with Safety Facilities/Site Inspection, Event Review Sharing, Contractor Safety Management, CORE Visit & Assessment Process, and Good Catch Quality Measure	TBD - From Corporate Safety	20.0%
	Diversity Goal	A stretch business unit Diversity goal based on “raw”* female and minority representation rate data.	0.0 = 0% improvement in business unit or operating company’s female and minority representation (equally weighted) 1.0= 0.5% improvement in business unit or operating company’s female and minority representation (equally weighted) 2.0 = 1% improvement in business unit or operating company’s female and minority representation (equally weighted)	2.5%
	Accountability Index	The accountability index measures the response to 3 survey questions Whether culture survey results were reviewed Whether action plans were created with team members Whether progress was discussed/tracked throughout the year	0.0 = 50% or less of business unit teams experience a year-on-year improvement 1.0 = 75% of business unit teams experience a year-on-year improvement 2.0 = 90% or more of business unit teams experience a year-on-year improvement	2.5%
	C100 Line Mechanic Recruitment Model	Develop recruitment and training plan to leverage various line mechanic colleges as a pipeline for C100 certified employees	TBD - Combination of Project Milestones and number of C100 Employees hired	5.0%
Customer 17.5%	**JD Power Quality & Reliability (PQR) Index Factor**	Power Quality & Reliability (PQR) Index Factor Score and related attribute questions align with the Customer Satisfaction breakthrough objective	0.0 – Maintain or decreased score regardless of peer movement 0.5 – Score increases less than peer average 1.0 – Increase equal to or greater than peer average 1.5 – Increase at least one and a half times the peer average 2.0 – Increase at least two times peer average 1.0 Adder = Score above peer average	7.5%
	JD Power Quality - Power Communications Index	Communications Index Factors Score and related attribute questions align with the Ease of Doing Business breakthrough objective	0.0 – Maintain or decreased score regardless of peer movement 0.5 – Score increases less than peer average 1.0 – Increase equal to or greater than peer average 1.5 – Increase at least one and a half times the peer average 2.0 – Increase at least two times peer average 1.0 Adder = Score above peer average	7.5%
	CMI Improvement	Improve two (2) components of the utility group's outage restoration process by [x %] over target (note: utility target or OPCo-specific target related to outage restoration will be derived in collaboration with the OPCos by 3/31/2020.	TBD	2.5%
Operational Excellence 27.5%	**SAIDI Actual**	SAIDI performance (shared goal with Transmission)	TBD w/ Transmission Input after End of Year SAIDI performance is calculated	5.0%
	Reliability Work Plans	Develop and execute reliability enhancement initiatives that improve system reliability. OPCo specific plans, as well as Distribution Services / Transmission joint plan	Measure: Develop company specific work plans to improve system reliability Target: End of Q1 finalize work plan for EVP approval. Complete all tasks in work plans by end of year (2.0); complete half (1.0)	10.0%
	Strategic Operational Excellence Work plan	Basket of strategic initiatives related to growing the competitive business, advancing technology solutions and advocating for improved Regulatory treatment. Bundle of four (4) strategic goals that will be selected by individual Operating Companies / Distribution Services and implemented per individual project plans.	Measure: See Note 1 Below Target: 0.0 = No Initiatives successfully completed 1.0 = 2 Initiative successfully completed 2.0 = 4 or more initiatives successfully completed*	12.5%
Financial 20%	**Net Income**	Meet or beat annual Earnings targets for Operating Companies in line with corporate expectations	TBD after YE results are known	20.0%

CERTIFICATE OF SERVICE

In accordance with Rule 4901-1-05, Ohio Administrative Code, the PUCO's e-filing system will electronically serve notice of the filing of this document upon the following parties. In addition, I hereby certify that a service copy of the foregoing *Direct Testimony of Andrew R. Carlin* was sent by, or on behalf of, the undersigned counsel to the following parties of record this 15th day of June 2020, via electronic transmission.

/s/ *Steven T. Nourse*
Steven T. Nourse

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