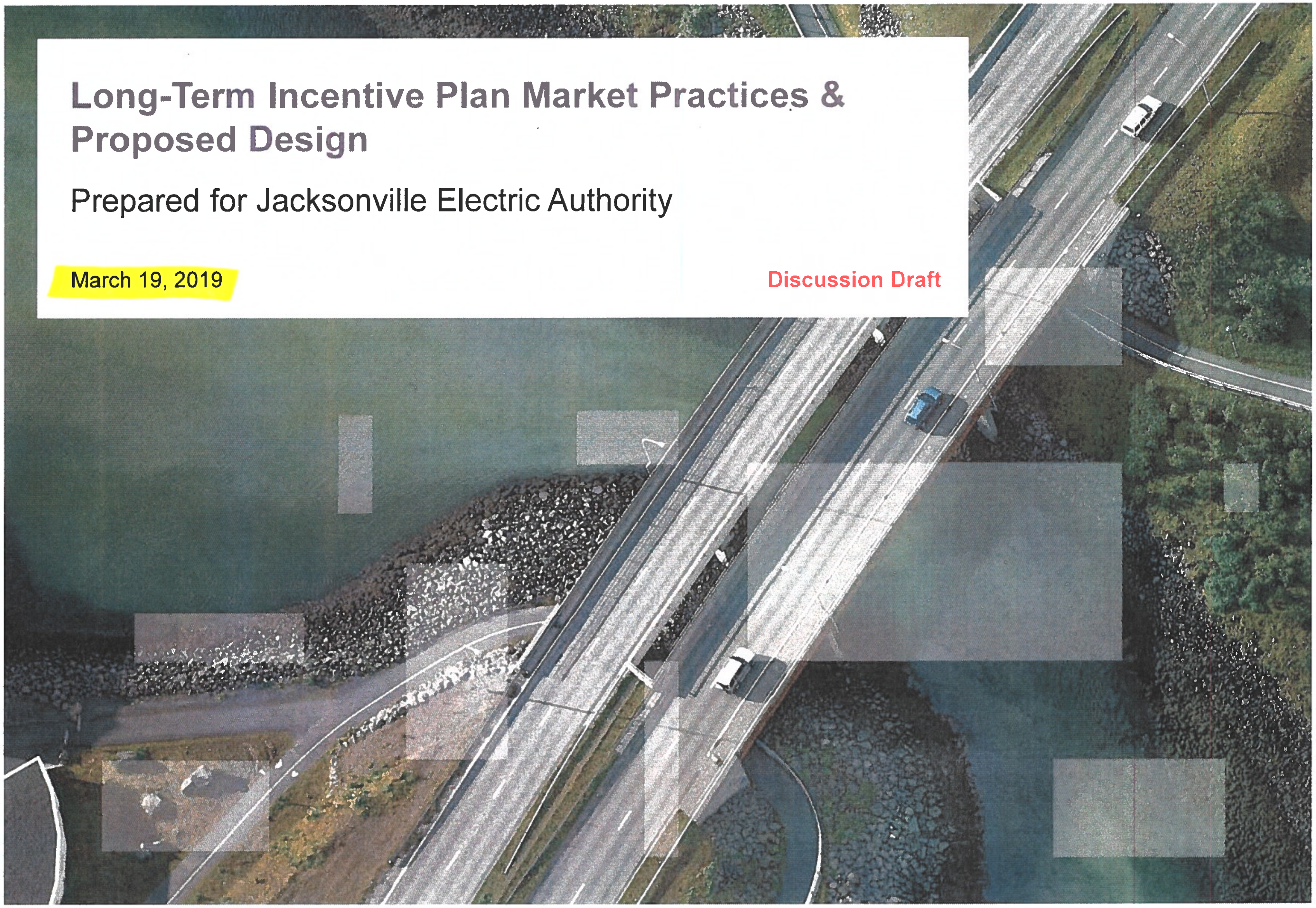
Long-Term Incentive Plan Market Practices & Proposed Design

Prepared for Jacksonville Electric Authority

March 19, 2019

Discussion Draft



Willis Towers Watson

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Introduction
Summary

- Jacksonville Electric Authority ("JEA") engaged Willis Towers Watson ("WTW") to complete the following:
  - Conduct an analysis of market competitive long-term incentive ("LTI") plan design practices in the utility industry, covering both investor owned utilities and public power utilities, and
  - Develop an LTI plan design that align with JEA's compensation philosophy and business strategy
- Pages 4 through 15 summarize competitive market practices for:
  - Investor Owned Utility (IOUs) peer group (comparably sized to JEA)
  - Public Power utilities (based on client work and anecdotal consulting experience)
  - Broader Utility Industry practices from WTW's *2018 Long-Term Incentives Policies and Practices Survey Report;* Energy Services Industry data cut reflecting predominantly IOU peer practices
- Pages 16 through 23 present LTI plan design alternatives and a strawman design for JEA's consideration

Introduction
Methodology

- WTW completed a competitive market analysis of LTI plan designs with regards to the following key design aspects:
  - Prevalence
  - Eligibility
  - Target incentive opportunity
  - Award frequency
  - Award vehicles
  - Performance metrics
  - Performance metrics weights
  - Performance range
  - Payout range
- The following perspectives were reviewed during the analysis:
  - IOU peer group practices
  - Public power utilities' practices
  - Broader Utility Industry practices

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Long-Term Incentive Plan Design Market Practices
Summary

Design Aspect	Public Power Utilities	Investor Owned Utility (IOU) Peer Group	Broader Utility Industry
Prevalence	LTI plans are uncommon	All 13 IOU peers have an LTI plan	LTI plans are very prevalent with almost all IOUs using an LTI plan
Eligibility	For those Public Power Utilities with an LTI plan, eligibility limited to select executives	Typically executives down to director level positions	Typically executives down to director level positions
Target Opportunity (% of Base Salary)	Varies widely based on the organization, but targets will be lower than IOU levels	Median for CEOs: 230% Median for NEOs*: 110% Median for Directors: NA	Median for CEOs: 240% Median for NEOs*: 75% Median for Directors: 15-25%
Award Frequency	Annual awards with overlapping cycles are most common	All 13 peers grant annual awards with overlapping cycles	98.1% of organizations grant annual awards and overlapping cycles are the most common

"NEOs" = Named Executive Officers, as disclosed in the IOU's proxy statement

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Long-Term Incentive Plan Design Market Practices

Summary (continued)

Design Aspect	Public Power Utilities	Investor Owned Utility (IOU) Peer Group	Broader Utility Industry
Award Vehicles	Cash-based performance plans	100% of peers use performance plans 69% use restricted stock No peers use stock options	93% of organizations use performance plans 66% use restricted stock 16% use stock options
Performance Metrics	Financial and operational	TSR (100%) EPS (38%) Operational (15%)	TSR (64%) EPS (22%) Other operational metrics are also common
Performance Metrics Weights	Operational metrics weighted more heavily than financial metrics	TSR and financial metrics weighted more heavily than operational metrics	Not available
Performance Range	More conservative compared to IOUs	Relative TSR: 28th %ile at threshold, 50th %ile at target, and 90th %ile at maximum	Relative TSR: 25th %ile at threshold, 50th %ile at target, and 90th %ile at maximum
Payout Range	Threshold: 50% of Target Maximum: 150% of Target	Threshold: 0-50% of Target Maximum: 150-200% of Target	Threshold: 50% of Target Maximum: 200% of Target

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Long-Term Incentive Plan Design Market Practices

Design Considerations

- At JEA's request, potential LTI plan designs for consideration are presented below
- They are arranged from most conservative to least conservative
  - A description of the plan designs and the advantages/disadvantages of each is presented later in this report (see "LTI Plan Design Alternatives" section)

no performance unit plan

Most Conservative → ***Least Conservative***

- __Option 1__: Voluntary Deferred Compensation Program __Without__ Company Matching
- __Option 2__: Voluntary Deferred Compensation Program __With__ Company Matching
- __Option 3__: Separate Long-Term Retention Award Budget
- __Option 4__: Profit-Sharing Plan
- __Option 5__: Long-term Performance Cash Plan With __Non-Overlapping__ Cycles
- __Option 6__: Long-term Performance Cash Plan With __Overlapping__ Cycles
- __Option 7__: Long-Term Performance and Retention Cash Plan

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Long-Term Incentive Plan Design Market Practices

Prevalence

- LTI plans are not commonly found at Public Power Utilities, but are very common at IOUs
  - In cases where a Public Power Utility does have a long-term incentive plan, it is usually only for the CEO or a small group of select executives
  - All 13 IOU peers have a LTI plan, and most IOUs utilize a portfolio approach, reflecting the use of multiple LTI vehicles (typically 2 vehicles)
- In the broader Utility Industry, almost all IOUs have a LTI plan

Public Power Utility Perspective:
Uncommon to have a LTI plan due to lack of long-term measures and stakeholder scrutiny/criticism

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Long-Term Incentive Plan Design Market Practices

Eligibility

- All 13 IOU peers have a LTI plan, eligibility typically covers executives to director level positions
- In the broader Utility Industry, position or title is the most common criteria used by organizations to determine eligibility for LTI awards
  - **70%** of organizations use position or title to determine eligibility for performance plans, **67%** for restricted stock, and **71%** for stock options (Director level typically the lowest title)
  - Award eligibility is as follows:

Broader Utility Industry: LTI Award Eligibility

LTI Vehicle	Median % of Eligible Employees	Median Lowest Midpoint Eligible ($000s)	Median Midpoint of 100% Participation ($000s)
Performance Plan	2.6%	$153.8	$175.7
Restricted Stock	5.0%	$135.3	$157.0
Stock Options	1.8%	$176.3	$192.9

Public Power Utility Perspective:
LTI eligibility is limited to the CEO and select executives only, broad based eligibility is not common

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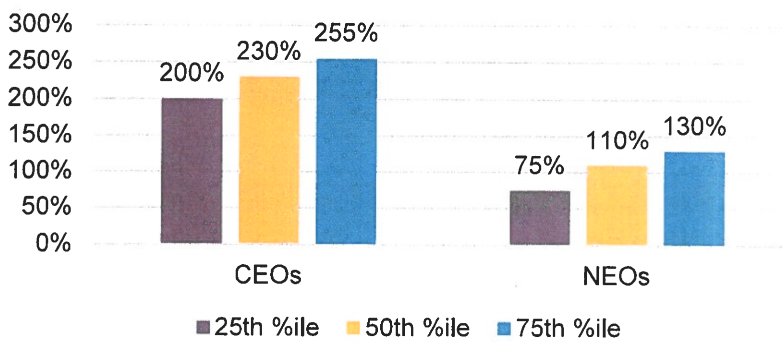
Long-Term Incentive Plan Design Market Practices

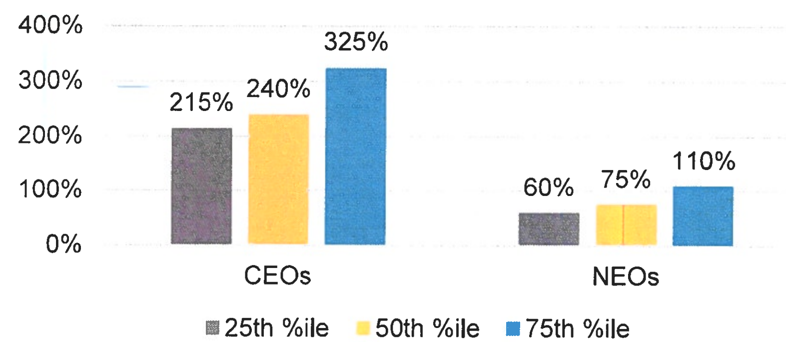
Target Incentive Opportunity

- Median target incentive opportunities are as follows:
  - IOU peer group: for CEOs is approximately **230%** and for NEOs is approximately **110%**
  - Broader Utility Industry*: for CEOs is approximately **240%** and for NEOs is approximately **75%**
    - For Directors is approximately **15-25%**

IOU Peer Group: LTI Target % for CEOs and NEOs



Broader Utility Industry: LTI Target % for CEOs and NEOs



Public Power Utility Perspective:
Target incentive opportunities vary widely based on the size of the Public Power Utility, however the targets are typically lower than what is common among the IOUs given the lower level of performance risk and sensitivity to not-for-profit focus

**Broader Utility Industry data reflects trend-line data from WTW's 2018 Energy Services Executive (Revenues from $1B-$3B) and MMPS Compensation Surveys*

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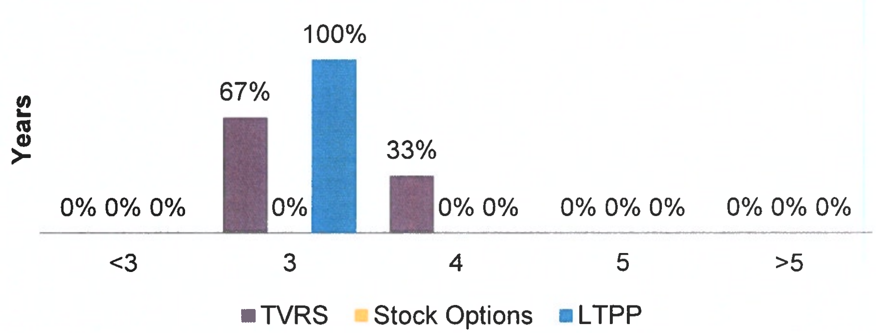
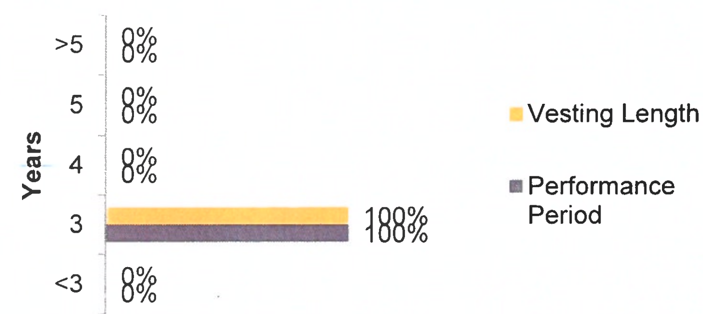
Long-Term Incentive Plan Design Market Practices

Award Frequency

- All 13 IOU peers grant awards on an annual basis with an attached vesting schedule
  - **98.1%** of the broader Utility Industry also grant annual LTI awards
- IOU peers attach a **3 to 4 year** vesting requirement on their LTI
  - A three-year cliff vesting schedule is the most common vesting requirement for performance plans
  - Restricted stock vesting is mixed between 3-4 years and cliff and ratable





Public Power Utility Perspective:
For the limited number of Public Power Utilities that make LTI grants, awards are most commonly awarded on an annual basis

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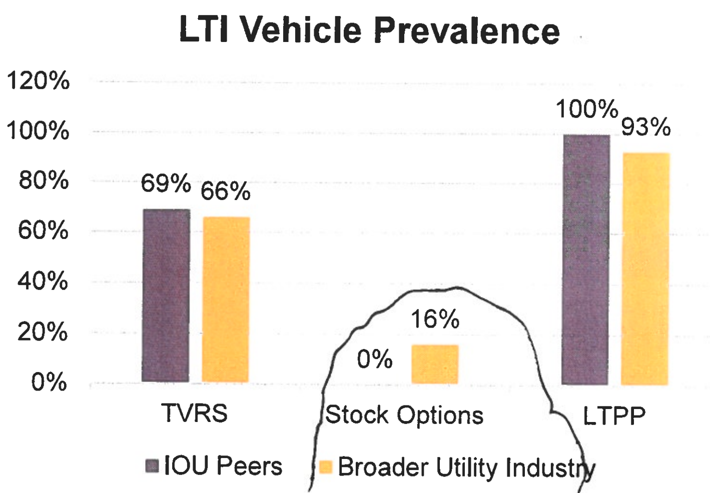
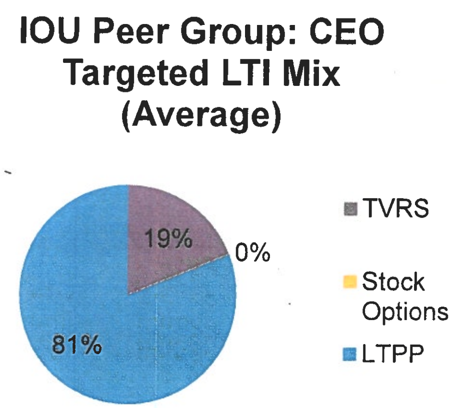
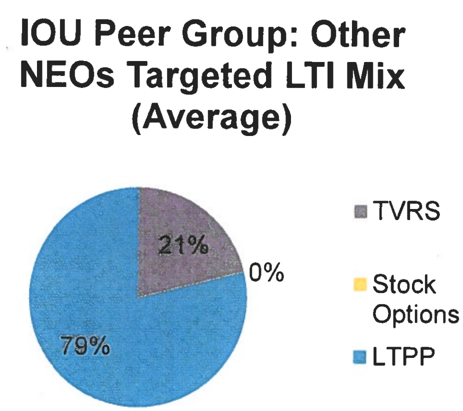
Long-Term Incentive Plan Design Market Practices

Award Vehicles

- Performance plans are much more common than restricted stock as an award vehicle for the IOU peer group, aligning with the broader Utility Industry
  - **100%** of the peers use performance plans and **69%** use restricted stock
  - On average, the CEO's LTI mix is comprised of performance plans at a slightly higher % than the other NEOs' LTI mix among the IOU peer group
- Unlike **16%** of the broader Utility Industry, **none** of the IOU peer group uses stock options as an award vehicle







Public Power Utility Perspective:
Performance cash awards are most common

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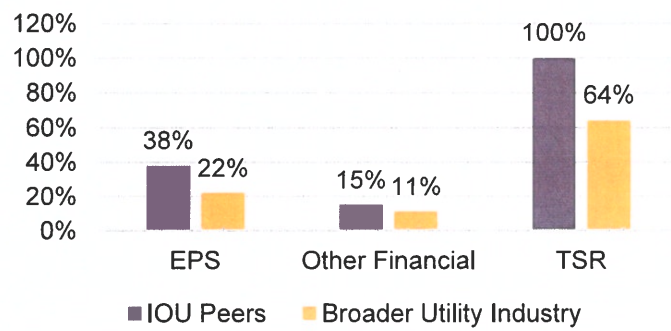
Long-Term Incentive Plan Design Market Practices

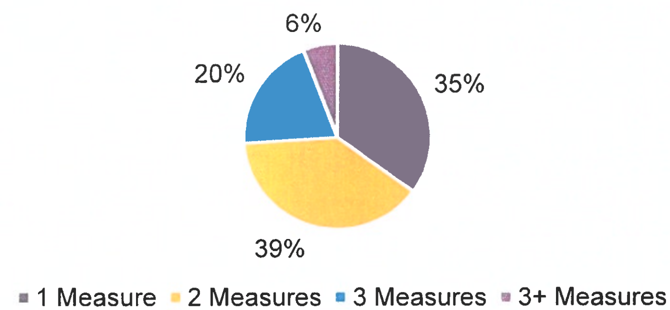
Performance Metrics

- LTI performance plans commonly consist of a mix of financial and operational metrics
- 9 of the 13 IOU peers utilize financial metrics while only 2 of the 13 peers utilize operational metrics
  - EPS is the most common financial metric for IOU peers and the broader Utility Industry
  - Operational metrics include health and safety, customer service, strategic measures, etc.
- All 13 IOU peers utilize relative TSR as a performance plan metric, much more prevalent than the broader Utility Industry

Financial and TSR Performance Metrics (% of Organizations)



Broader Utility Industry: # of Metrics



Public Power Utility Perspective:
Common for Public Power Utilities to have a mix of financial and operational metrics for their performance plans

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Long-Term Incentive Plan Design Market Practices
Performance Metrics Weights

- LTI performance metrics have specific weightings based on the organization's long-term strategies and goals
- For the 2 IOU peers that utilize operational metrics, the weightings are 50% for one peer and not disclosed for the other peer
- For the IOU peers that utilize relative TSR and EPS metrics, the approximate median weightings are as follows:

Performance Measure	Weight (%)
Relative TSR	67%
EPS	25%

Public Power Utility Perspective:
Operational metrics typically have higher weights than financial metrics; measure weighting typically reflective of the importance and focus placed on the measure

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Long-Term Incentive Plan Design Market Practices
Performance Range

- The width of performance ranges (e.g. the difference between threshold/maximum performance goals and target) vary by performance metric
  - All 13 of the IOU peers have a relative TSR component in their LTI performance plan
  - Relative TSR and EPS have the following median performance ranges:

Performance Measure	IOU Peer Group			Broader Utility Industry		
	Threshold (% of Target)	Target	Maximum (% of Target)	Threshold (% of Target)	Target	Maximum (% of Target)
Relative TSR (%ile Rank)	28^{th} %ile	50^{th} %ile	90^{th} %ile	25^{th} %ile	50^{th} %ile	90^{th} %ile
EPS	98%	100%	102%		*NA*	

Public Power Utility Perspective:
Common for performance ranges to be more conservative (more narrow) compared to IOU peer group and broader Utility Industry, as performance outcomes are less volatile

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Long-Term Incentive Plan Design Market Practices
Payout Range

- Payout ranges are often provided as a percentage of the target incentive opportunity (target is equal to 100% payout)
- The IOU peer groups' threshold and maximum payouts as a % of target align with what is most common in the broader Utility Industry

Payout Range	IOU Peer Group	Broader Utility Industry
Threshold	Range of 0%-50% Median: 50%	50%
Target	100%	100%
Maximum	Range of 150%-200% Median: 200%	200%

Public Power Utility Perspective:
Payout ranges are similar to both IOU Peer Group and broader Utility Industry with thresholds typically at around 50% and maximums typically at 150%

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Long-Term Incentive Plan Design Alternatives

Option 1: Voluntary Deferred Compensation Program <u>Without</u> Company Match

Description of Plan

- Employee can voluntarily defer all or a portion of pay (typically defined as some portion of base salary and all of bonus) into a non-qualified deferred compensation account
  - No cost would be incurred by the company
  - Employees can delay taxation until a later date (e.g. retirement)

	To JEA	To Employee
Advantages	• No cost to company • Easy to administer	• Taxation is delayed (probably until retirement)
Disadvantages	• Limited retention value given relatively small gain compared to IOU LTI programs • Does not align with public power utility market practice	• Risk of loss if company goes bankrupt (non-qualified plan means no protection from creditors) • Deferred compensation is not liquid given IRC 409(A) restrictions

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Long-Term Incentive Plan Design Alternatives

Option 2: Voluntary Deferred Compensation Program With Company Match

Description of Plan

- Employee can voluntarily defer all or a portion of pay (typically defined as some portion of base salary and all of bonus) into a non-qualified deferred compensation account and receive a matching contribution from the company; company match dependent on achieving defined financial performance

	To JEA	To Employee
Advantages	• Limited cost to company • Easy to administer • Creates a retention incentive for employee to stay (to receive full company match)	• Taxation is delayed (typically until retirement)
Disadvantages	• Limited retention value given relatively small gain compared to IOU LTI programs • Does not align with public power utility market practice	• Company match not guaranteed given performance requirement • Risk of loss if company goes bankrupt (non-qualified plan means no protection from creditors) • Deferred compensation is not liquid given IRC 409(A) restrictions

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Long-Term Incentive Plan Design Alternatives

Option 3: Separate Long-Term Retention Award Budget

Description of Plan

- Organization has a separate budget (similar to merit budget) that focuses entirely on long-term retention awards for high performers and key roles

	To JEA	To Employee
Advantages	• Creates a retention incentive for high performers or key employees to stay	• Employee can receive annual value attached to retention award with ratable vesting
Disadvantages	• Limited retention value given relatively small gain compared to IOU LTI programs • Does not align with public power utility market practice • Potentially subject to criticism/scrutiny from outside observers given not common among public power utilities	• May not receive an award depending on individual performance and size of the allocated retention budget for that year • Some key roles will receive higher awards despite performance levels

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Long-Term Incentive Plan Design Alternatives
Option 4: Profit-Sharing Plan

Description of Plan

- An employer shares a percentage of earnings or profit with employees based on pre-established multi-year financial goal(s); payouts would be at the end of the performance cycle and in cash, assuming requisite performance goals achieved

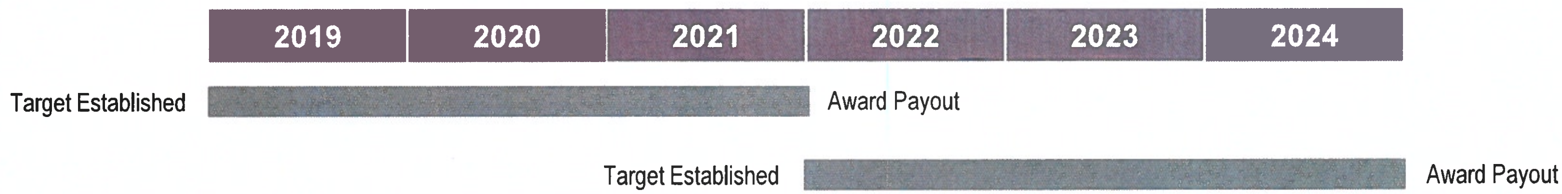
	To JEA	To Employee
Advantages	• Promotes pay-for-performance philosophy • Flexibility to decide how much profit (if any) to share with employees	• Employee can receive annual value attached to profit-sharing plan • Plan creates a sense of ownership in the company
Disadvantages	• Limited retention value given relatively small gain compared to IOU LTI programs • Does not align with public power utility market practice • Subject to criticism/scrutiny from outside observers given not common among public power utilities • Could receive additional negative criticism given the potential for payouts during periods of poor company performance • Limited retention value as no post performance cycle vesting required	• May not receive an award depending on company's decision to share profits or if company performance is poor • Payouts typically not differentiated based on individual employee performance

Long-Term Incentive Plan Design Alternatives

Option 5: Long-Term Performance Cash Plan With Non-Overlapping Cycles

Description of Plan

- Employee receives a triennial, non-overlapping grant of performance cash based on predetermined financial, operational, and/or strategic objectives



	To JEA	To Employee
Advantages	• Promotes pay-for-performance philosophy • Use of performance plan aligns with IOUs • Creates incentive for employee to deliver sustained (multi-year) financial and operational results	• Opportunity to receive significant award after conclusion of three-year period
Disadvantages	• Does not align with public power utility market practice • Subject to criticism/scrutiny from outside observers given not common among public power utilities • Limited "line of sight" or ability of employees to impact defined performance measure outcomes; typical line of sight limited to select group of senior employees	• Non-overlapping cycle increases the risk of forfeiture due to leaving the company • Non-overlapping cycle prevents the employee from receiving an annual value from the performance cash • Non-overlapping cycle increases the chances that "one bad year" could make achievement of three-year goals difficult to achieve • All performance-based, no consideration for sustained service • Plans/measures can be complex to understand and communicate

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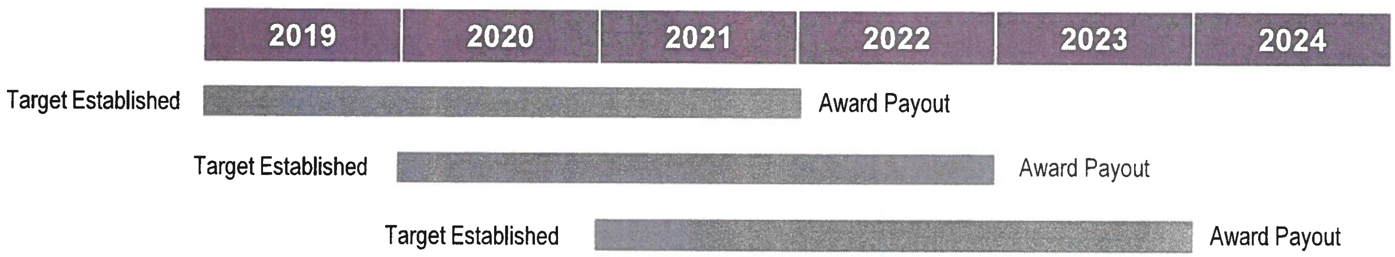
Long-Term Incentive Plan Design Alternatives

Option 6: Long-Term Performance Cash Plan With Overlapping Cycles

Description of Plan

- Employee receives an annual, overlapping grant of performance cash based on predetermined financial, operational, and strategic objectives



	To JEA	To Employee
Advantages	• Promotes pay-for-performance philosophy • Greater alignment with IOU peers (more than non-overlapping plans) • Creates incentive for employee to deliver sustained (multi-year) financial and operational results • Most common design used by public power utilities with LTI	• Employee can receive annual value attached to long-term incentive plan • Rolling three-year performance periods means that "one bad year" can't make goals unachievable • Opportunity to receive significant award after conclusion of three-year period
Disadvantages	• Does not align with public power utility market practice • Subject to criticism/scrutiny from outside observers given not common among public power utilities • Limited "line of sight" or ability of employees to impact defined performance measure outcomes; typical line of sight limited to select group of senior employees	• All performance-based, no consideration for sustained service • Plans/measures can be complex to understand and communicate

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Long-Term Incentive Plan Design Alternatives

Option 7: Long-Term Performance Cash and Retention Cash Plan

Description of Plan

- A mix of long-term cash linked to both company performance <u>and</u> continued employment
  - The mix would be weighed more heavily towards the performance-based component (e.g., 75%/25% performance-based to service/time-based)

	To JEA	To Employee
Advantages	• Promotes pay-for-performance philosophy • Creates incentive for employee to deliver sustained (multi-year) financial and operational results • Time-based portion creates strong retention incentive to employee (even during periods when company performance is poor) • Design that most closely aligns with IOU LTI designs	• Time-based portion provides opportunity for payout even if company performance is poor • Employee can receive annual value attached to long-term incentive plan • Opportunity to receive significant award after conclusion of three-year period
Disadvantages	• Does not align with public power utility market practice • Subject to criticism/scrutiny from outside observers given not common among public power utilities • Limited "line of sight" or ability of employees to impact defined performance measure outcomes; typical line of sight limited to select group of senior employees	• No upside potential (e.g. maximum opportunity) would be attached to the time-based portion of the LTI • Plans/measures can be complex to understand and communicate

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Long-Term Incentive Plan Design Strawman
Proposed Strawman Design

- *Given consideration of the overarching goal to allow all employees to share in the long-term success of the company and public power utility LTI market practices, we propose a multi-pronged LTI design approach below for consideration:*

Employee Population	Plan Design Overview
Select Executives	• **Design:** long-term performance cash grants tied to 3-year performance cycle • **Eligibility:** limited to select executives (i.e., CEO, COO) with direct ability to influence performance • **Frequency:** annual grants (overlapping award cycles) • **Performance Measures:** tied to achievement against defined financial and/or operational performance measures; tied to 2 to 3 key measures where performance can be set for a multi-year period
All Employees	• **Design:** voluntary deferred compensation plan with company match tied to overall company financial performance; deferral of some portion of pay (base salary and/or bonus) allowed • **Eligibility:** all employees • **Company match:** tied to long-term company financial performance with match dependent on level of performance achieved
Employees with Critical Skills or Retention Risk	• **Design:** long-term company performance funds supplemental long-term award pool used to make long-term retention cash awards; awards vest upon completion of defined service period (i.e., cliff vest end of year 3 from grant) • **Eligibility:** critically skilled employees or employees viewed as retention risks

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Appendix

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Appendix
Utility Peer Group

IOUs (13 Companies)

- ALLETE
- Alliant Energy
- Avista
- Black Hills
- El Paso Electric
- Hawaiian Electric Industries
- NorthWestern Energy
- OGE Energy
- Otter Tail
- Pinnacle West Capital
- PNM Resources
- Portland General Electric
- Vectren

Public Power Utilities

- *Six public power utility clients*
- *Anecdotal consulting experience*

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