WESTERN RESOURCES BOARD OF DIRECTORS
HUMAN RESOURCES COMMITTEE
January 27, 1999

The Western Resources Human Resources Committee of the Board of Directors met at a regular meeting on January 27, 1999. The following members were present: Frank J. Becker, John C. Dicus and David H. Hughes. Participating from Western Resources were David C. Wittig and Carl M. Koupal, Jr. Also in attendance from Deloitte and Touche Performance Management Consulting were: Brent Longnecker, national practice director, and Cara King, senior consultant.

The Committee reviewed and approved the minutes of the November 18, 1998, meeting.

The Committee then reviewed the results of the short-term incentive plan and proposed total incentives for members of the Executive Council and other officers. It was moved and seconded, and the resolution was approved as presented to the Committee.

The Committee then reviewed the proposal for the stock options for 1999 to be at the same levels as those options granted in 1998. It was explained to the Committee that all of the stock option numbers were exactly the same as those approved in 1998 and that in May, 1999, additional information would be presented to make appropriate adjustments for stock options and restricted shares for 1999. The Committee reviewed those recommendations and after discussion, approved the resolution approving the stock options.

The Committee then moved to a review of the stock compensation program which had also been reviewed by the Committee at its November 18, 1998, meeting. The Committee approved the resolution recommending this matter be approved by the full Board.

The Committee also reviewed the proposal to amend the 401(k) plan to provide for the company match of the 401(k) to be made in company stock rather than cash. The Committee approved the resolution recommending that this be reviewed and approved by the full Board.

Next the Committee reviewed the long-term incentive grant revisions as presented in the Deloitte and Touch presentation. The resolution was moved and seconded and approved by the Committee.

The Committee then heard a review of a proposal dealing with "one-time" capital gains as presented in the Deloitte and Touche presentation, which was also moved, seconded and approved and recommended by the Committee for full Board review.

The Committee also reviewed, based on the presentation by Deloitte and Touche, the inclusion of the short-term incentive plan for Section 162(m) purposes and moved, seconded and recommended that resolution for the full Board, as well.

Submitted by,

Carl M. Koupal, Jr.

WS030287

Western Resources

CARL M. KOUPAL, JR.
*Executive Vice President and*
*Chief Administrative Officer*

January 13, 1999

To: Mr. John C. Dicus
Mr. David H. Hughes

Gentlemen:

Chairman Becker has asked that I notify you of a meeting of the Human Resources Committee of the Board of Directors on January 27 at 1:00 p.m. The meeting will be held in the west conference room of the 11th floor.

We look forward to seeing you.

Sincerely,

CMK/naf
cc: Mr. Frank J. Becker
Mr. David C. Wittig
Mr. Richard D. Terrill

818 South Kansas Avenue / P.O. Box 889 / Topeka, Kansas 66601
Telephone: (785) 575-6358 / Fax: (785) 575-1563
Mobile: (785) 224-4070 / Internet: carl_koupal@wstnres.com

Western Resources

CARL M. KOUPAL, JR.
Executive Vice President and
Chief Administrative Officer

January 20, 1999

Via Federal Express
Mr. Frank J. Becker
7740 E. Gainey Ranch Road 35
Scottsdale, AZ 85258

Dear Frank:

In preparation for our telephone conversation Friday morning, enclosed please find drafts of the following information:

- Agenda for the Human Resources Committee meeting;
- Recommendations on the short-term incentive plan results for 1998;
- Approval of stock options-1999;
- Review of stock compensation plan.

In a separate overnight package, you should receive directly from Deloitte & Touche a draft presentation addressing the following items:

- Proposed revisions to the long-term incentive plan;
- Review of the proposal for "one-time" capital gains;
- A proposal that the short-term incentive plan be included for purposes of 162(m).

I look forward to visiting with you on Friday morning, 7:00 a.m. your time, concerning these matters.

Sincerely,

CMK/naf
Enclosures

818 South Kansas Avenue / P.O. Box 889 / Topeka, Kansas 66601
Telephone: (785) 575-6358 / Fax: (785) 575-1563
Mobile: (785) 224-4070 / Internet: carl_koupal@wstnres.com

DRAFT

Human Resources Committee
Agenda
January 27, 1999

| | Items | Requires | Tab |
|---|---|---|---|
| I | Review and approval of Minutes of November 18, 1998 meeting | Committee | A |
| II | Review of short-term incentive plan results for 1998 1998 accomplishments and | Resolution/ Committee | B |
| III | Review of stock options - 1999 | Resolution/ Committee | C |
| IV | Review of stock compensation plan | Resolution/ Committee | D |
| V | Amendments to 401(k) plan to provide match in company stock C.K. | Resolution/ Committee/ Board | E |
| VI | Revisions to Long-Term Incentive Plan. | Resolution/ Committee | F |
| VII | Review of compensation proposed for "one-time" capital gains | Resolution/ Committee/ Board | G |
| VIII | Short-Term Incentive Plan - Inclusion in 162(M). | Resolution/ Committee/ Board | H |
| IX | Other business | | I |
| | Adjourn | | |

WS030290

DRAFT

# 1998 Officer Short Term ~~Incentives~~ Recommendation (paid in 2/99)

| Officer | Salary | Incentive Target | ~~Actual~~ Total Incentive % | ~~Actual~~ Total Incentive $ | Individual | EPS (Exempt) | Stock Price (Exempt) | Incentive Components SVA | Incentive Components Safety Lost Time | Incentive Components Safety Incident | Incentive Components CS SAIDI | Incentive Components CS Survey |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| David Wittig | 715,000 | 80.000% | 16.000% | 114,400 | 16.000% | 0.000% | 0.000% | | | | | |
| Doug Lake | 377,000 | 60.000% | 4.000% | 15,080 | 12.000% | 0.000% | 0.000% | | | | | |
| Carl Koupal | 306,000 | 60.000% | 12.000% | 36,720 | 12.000% | 0.000% | 0.000% | | | | | |
| Bill Moore (11/16 - 12/31) | 203,000 | 60.000% | 1.500% | 3,045 | 12.000% | 0.000% | 0.000% | | | | | |
| Bill Moore (1/1 - 11/15) | 166,000 | 45.000% | 41.143% | 68,298 | 22.500% | 0.000% | | 16.540% | 1.125% | 0.109% | 4.520% | 2.227% |
| | | | | 71,843 | | | | | | | | |
| Tom Grennan (11/16 - 12/31) | 203,000 | 60.000% | 1.500% | 3,045 | 12.000% | 0.000% | 0.000% | | | | | |
| Tom Grennan (1/1 - 11/15) | 166,000 | 45.000% | 26.769% | 44,436 | 22.500% | 0.000% | | 0.000% | 4.718% | 3.375% | | |
| Tom Grennan Total | | | | 47,481 | | | | | | | | |
| Rick Terrill (11/16 - 12/31) | 178,000 | 60.000% | 1.500% | 2,670 | 12.000% | 0.000% | 0.000% | | | | | |
| Rick Terrill (1/1 - 11/15) | 138,000 | 30.000% | 10.500% | 14,490 | 12.000% | 0.000% | 0.000% | | | | | |
| | | | | 17,160 | | | | | | | | |
| Rita Sharpe | | | | | | | | | | | | |
| Jim Martin | | | | | | | | | | | | |
| Annette Beck (10/1 - 12/31) | | | | | | | | | | | | |
| Annette Beck (1/1 - 12/31) | | | | | | | | | | | | |
| Les Morgan (10/1 - 12/31) | | | | | | | | | | | | |
| Les Morgan (1/1 - 12/31) | | | | | | | | | | | | |
| Wayne Kitchen | | | | | | | | | | | | |
| Carl Ricketts | | | | | | | | | | | | |
| Doug Henry (10/1 - 12/31) | | | | | | | | | | | | |
| Doug Henry (1/1 - 12/31) | | | | | | | | | | | | |
| Jo Hunt | | | | | | | | | | | | |
| Total Officer Incentives | | | | | | | | | | | | |

REDACTED

DRAFT

# 1999 Option & Restricted Share Grants

| Officer | PG | # of Employees | Total Options | Restricted Shares |
|---|---|---|---|---|
| David Wittig | 1 | 1 | 113,000 | 42,000 |
| Douglas Lake | 4 | 1 | 30,000 | 13,500 |
| Carl Koupal | 5 | 1 | 28,000 | 13,000 |
| Richard Terrill | 7 | 1 | 8,000 | |
| William Moore | 7 | 1 | 12,000 | |
| Thomas Grennan | 7 | 1 | 12,000 | |
| Rita Sharpe | 9 | 1 | 8,000 | |
| James Martin | | | | |
| Annette Beck | | | | |
| Wayne Kitchen | | REDACTED | | |
| Carl Ricketts | | | | |
| Leslie Morgan | | | | |
| Douglas Henry | | | | |
| Jo Hunt | | | | |
| | A | 10 | 27,650 | |
| | B | 21 | 49,600 | |
| | C | 53 | 125,640 | |
| | D | 105 | 67,140 | |
| | DD | 48 | 17,040 | |
| | E | 115 | 35,030 | |
| | F | 92 | 19,380 | |
| | G | 91 | 14,810 | |
| | H | 51 | 6,370 | |
| | I | 65 | 5,500 | |
| | Nonexempt | 237 | 20,830 | |
| Total Option or Shares | | | 641,690 | 68,500 |

DRAFT

# Stock Compensation Program

Western Resources

# Stock Compensation Program

Objectives

- Strengthen link between individual reward and company performance.

- Increase stock ownership by senior management.

Western Resources

# Stock Compensation Program

Key Characteristics

- Portion of compensation paid in the form of stock (restricted share units).

- Number of shares determined on the basis of market value of common stock, discounted 15%.

- Proportion of cash vs. stock is determined through a formula applied to all compensation increases.

Western Resources

# Stock Compensation Program

Key Characteristics

- At the time of grant, employee determines deferral period (no less than 3 years).
- Dividends paid in cash or reinvested, at employee election.
- Common stock is issued to the employee at the end of the deferral period.

Western Resources

# Stock Compensation Program

Formula

| Total Base Comp. | Stock % | Stock at Max. |
|---|---|---|
| 0-50,000 | 2.5% | $1,250 |
| 50,000-75,000 | 10% | $3,750 |
| 75,000-100,000 | 15% | $7,500 |
| 100,000-150,000 | 25% | $20,000 |
| 150,000-250,000 | 50% | $70,000 |
| Greater than 250,000 | 75% | - |

Example: Base = $106,00

Stock Requirement = 9,000 (7,500 + (.25 x 6,000)

Western Resources

# Stock Compensation Program

- Program would be phased-in over a three year period. The formula would apply only to increases in compensation.
- Program for the first year applies to officers and senior management in Grades A and B. This is the top 46 employees of the company.
- Any officer could participate to the full amount of the formula beginning in year one.

Western Resources

Western Resources

CARL M. KOUPAL, JR.
*Executive Vice President and*
*Chief Administrative Officer*

January 25, 1999

Via Federal Express
To: Mr. Frank J. Becker
Mr. John C. Dicus
Mr. David H. Hughes

Gentlemen:

Enclosed please find the agenda items for the Human Resources Committee meeting scheduled for January 27 at 1:00 p.m.

You will be receiving under separate cover from Deloitte & Touche the items for tabs "F", "G", and "H" on the agenda.

If you have any questions, please give me call.

Sincerely,

CMK/naf
cc: Mr. David C. Wittig
Mr. Richard D. Terrill

818 South Kansas Avenue / P.O. Box 889 / Topeka, Kansas 66601
Telephone: (785) 575-6358 / Fax: (785) 575-1563
Mobile: (785) 224-4070 / Internet: carl_koupal@wstnres.com

# Human Resources Committee

January 27, 1999

Western Resources

Human Resources Committee
Agenda
January 27, 1999

| | Items | Requires | Tab |
|---|---|---|---|
| I | Review and approval of Minutes of November 18, 1998 meeting | Committee | A |
| II | Review of short-term incentive plan results for 1998 | Resolution/ Committee | B |
| III | Review of stock options - 1999 | Resolution/ Committee | C |
| IV | Review of stock compensation plan | Resolution/ Committee/ Board | D |
| V | Amendments to 401(k) plan to provide match in company stock | Resolution/ Committee/ Board | E |
| VI | Revisions to Long-Term Incentive Grants | Resolution/ Committee | F |
| VII | Review of compensation proposed for "one-time" capital gains | Resolution/ Committee/ Board | G |
| VIII | Short-Term Incentive Plan - Inclusion in 162(M) | Resolution/ Committee/ Board | H |
| IX | Other business | | I |
| | Adjourn | | |

A

Minutes
Western Resources Board of Directors
Human Resources Committee
November 18, 1998

The Human Resources Committee met at a regular meeting on November 18, 1998. The following members were present: Frank J. Becker, John C. Dicus and David H. Hughes. Participating from Western Resources were David C. Wittig and Carl M. Koupal, Jr. for portions of the meeting. Also in attendance from Deloitte and Touche Performance Management Consulting were Brent Longnecker, national practice director, and Cara King, senior consultant.

The Committee began in executive session with David C. Wittig and Brent Longnecker to review the proposed salary adjustments for members of the Executive Council. The Committee approved the resolution changing the annual compensation of the Executive Council as presented at the meeting and changing the title of Thomas L. Grennan to Executive Vice President.

The Committee also reviewed the proposal contained in the Deloitte and Touche study to require deferral of a percentage of base salary to be paid in Western Resources stock. After considerable discussion on this item, the Committee agreed to the proposal as presented but requested that the phase-in on the total deferral amounts would be three years rather than two years, providing that any employee could begin the full amount of the deferral in the first year.

The Committee also received a presentation by Brent Longnecker on an analysis of compensation trends, specifically reviewing certain aspects of the Western Resources long-term incentive program and trends in the area of employment contracts and handling of large one-time capital gains.

The Committee also reviewed an amendment to the Western Resources 401(k) plan and approved the resolution making those revisions to the employees' 401(k) plan.

Submitted by,

Carl M. Koupal, Jr.

B

# 1998 Officer Short Term Incentive Recommendations

| Officer | Salary | Incentive Target | 80% Financial Target EPS | 80% Financial Target Stock Price | 20% Discretionary | Other Components | Total Incentive |
|---|---|---|---|---|---|---|---|
| John Hayes | 715,000 | 80% | 0 | 0 | 114,400 | 0 | 114,400 |
| David Wittig | 715,000 | 80% | 0 | 0 | 114,400 | 0 | 114,400 |
| Doug Lake (9/1 - 12/31) | 377,000 | 60% | 0 | 0 | 15,080 | 0 | 15,080 |
| Carl Koupal | 306,000 | 60% | 0 | 0 | 36,720 | 0 | 36,720 |
| Bill Moore (11/16 - 12/31) | 203,000 | 60% | 0 | 0 | 3,045 | 0 | 3,045 |
| Bill Moore (1/1 - 11/15) | 166,000 | 45% | 0 | - | 32,681 | 35,617 | 68,298 |
| Bill Moore Total | | | | | | | 71,343 |
| Tom Grennan (11/16 - 12/31) | 203,000 | 60% | 0 | 0 | 3,045 | 0 | 3,045 |
| Tom Grennan (1/1 - 11/15) | 166,000 | 45% | 0 | - | 32,681 | 11,755 | 44,436 |
| Tom Grennan Total | | | | | | | 47,481 |
| Rick Terrill (11/16 - 12/31) | 178,000 | 60% | 0 | 0 | 2,670 | 0 | 2,670 |
| Rick Terrill (1/1 - 11/15) | 138,000 | 30% | 0 | - | 14,490 | 0 | 14,490 |
| Rick Terrill Total | | | | | | | 17,160 |
| **Total EC Incentives** | | | | | | | **416,584** |
| [redacted] | | | | | | | |
| Rita Sharpe (9/1 - 12/31) | | | | | | | |
| Rita Sharpe (1/1 -8/31) | | | | | | | |
| Rita Sharpe Total | | | | | | | |
| Jim Martin | | | | | | | |
| Annette Beck (10/1 - 12/31) | | | | | | | |
| Annette Beck (1/1 - 12/31) | | | | | | | |
| Annette Beck Total | | | | | | | |
| Les Morgan (10/1 - 12/31) | | | | | | | |
| Les Morgan (1/1 - 12/31) | | | | | | | |
| Les Morgan Total | | | | | | | |
| Wayne Kitchen | | | | | | | |
| Carl Ricketts | | | | | | | |
| Doug Henry (10/1 - 12/31) | | | | | | | |
| Doug Henry (1/1 - 12/31) | | | | | | | |
| Doug Henry Total | | | | | | | |
| Jo Hunt | | | | | | | |
| **Other Officer Total** | | | | | | | |
| **Total Officer Incentives** | | | | | | | |

REDACTED

TO: Compensation Committee

FROM: David C. Wittig

DATE: January 5, 1999

SUBJECT: 1998 Performance Self Assessment

CC:

Western Resources

INTERNAL CORRESPONDENCE

---

1998 was a transition year for Western Resources. Not only did we transition management teams, but we also transitioned business philosophy. As a result, we are diligently working to address the quality of our earnings, our balance sheet, and our operating assets.

This effort will involve writing off certain assets, setting up more conservative reserves, and investing significantly more money in utility operations and maintenance. Transmitting that message to our shareholders has resulted in a repricing of our stock and a wait-and-see attitude.

The by-product of these actions will be to miss our 1998 projections and to underperform the market. Our short-term performance based incentive payout will be zero. I think I share the sentiments of the rest of the management team when I say that these actions had to be done, and now it is time to move forward.

When I look back at my personal accomplishments for 1998, I think about what have I done to build value for our long-term investors.

Specifically, we ~~have~~ accomplished the following:

1. Embarked on a construction program at the utility to better prepare Western to meet the energy needs of our region over the next five years. We have been prudent in our plans with a greater emphasis on flexibility in our production profile (i.e., we are building smaller gas-fired plants to meet specific needs ahead of our competitors).

2. Restructured the KCPL transaction in order to create a pure play utility in Westar Energy. Westar will provide the Western shareholder with a steady dividend stream one step removed from regulation.

3. Grew P-1 from 750,000 to 2,000,000 (with the completion of Lifeline) in total customers, while maintaining flexibility in the capital structure so that P-1 is not entirely dependent on Western for its growth capital.

4. Restructured the utility in anticipation of the KCPL merger providing greater responsibility for our second tier of management. I must also point out with pride that 29% of our current senior management is either female or minorities as opposed to 7% in 1995.

5. Restructured the compensation system heavily weighted to a pay-for-performance philosophy. Reduced the number of exempt pay grades from 14 to 10 in an effort to flatten the organization.

6. I have continued to increase my involvement in the community. I was a member of Mayor Joan Wagnon's Transition Team, and was the Regional Walk chairman for the March of Dimes.

On the attached sheets I have made my recommendations for incentive payouts for my direct reports. In all cases, because there is no payout for earnings or stock performance, I am recommending the full payout of the discretionary portion of compensation. In terms of my own payout, that, of course, is your choice.

I thank you for the opportunity to lead this company.

## Customer Service

- Justified customer complaints were reduced from 48 to 18 for the time period of January-November 1997 to January-November 1998.
- A new IVR (Integrated Voice Response) system and related software were implemented in the Wichita and Topeka phone centers increasing the IVR handling rate from 9% to 18% in Wichita and from 12.5% to 25% in Topeka. This, along with screen pops and other initiates, allowed us to reduce our abandoned call rate to a "storm normalized" number of 5% and meet the Kansas Gas Service commission service standard requirement. Over $300,000 in labor reductions have been achieved due to this implementation.
- A customer service e-mail system was set up for our customers via the Internet. Efforts are under way to allow customers the ability to access their accounts by Internet and should be available within the next few months.
- The Commercial and Industrial Business Center will be opening in January. This will provide our top 500 customers a more personalized experience every time they interact with us. The top 50 customers continue to have individuals assigned directly to them.
- Bad debts were reduced from $4.7 million in 1997 to an estimated $4.4 million in 1998. Arrears were reduced from $8 million to $5 million in 1998.
- Clean up was finished on billing issues found in 1996 when the Billing Team was formed. Two major issues accomplished this year include correction of Commercial versus Residential rate miscodings, and correction of Outside Tax authority miscodings.

## Power Delivery

- As currently configured, Power Delivery is a true "wires" business, providing transport services from generator to customer. An active weather pattern in late spring/early summer, resulted in abnormally active storm activity requiring unbudgeted expenditures of $3.8 million in capital and $5.8 million in O&M.
- Although many work locations achieved excellent safety results, Power Delivery's overall incident rate rose from the 1997 level. Unfortunately, there was one fatality included due to an equipment failure at the Allen substation. The recent reorganization includes the ability to increase focus and attention in this critical area.
- The system operations group achieved near perfect results while issuing nearly 30,000 clearances, hot permits, and trouble tickets with only one switching error.
- Key management personnel continue to be very involved in transmission re-regulation activities at the Southwest Power Pool and national level.
- T&D inventory levels have been reduced $7.3 million through November 1998, with an improvement in inventory turnover from 2.68 to 3.31.

## Strategic Governance

- Strategic Governance is a newly created department. In addition to support for strategic planning for all the Electric Utility business units, this department helps formalize the shared services organization for the Electric Utility.

## Power Supply - Risk Management

- This is a newly created department in 1998 formed in response to the rapidly changing wholesale power market. In 1998, credit risk monitoring, market risk monitoring, and deal tracking for all marketing companies in which we transact business was established, and we continue to work on an improved bilateral contract in which we conduct our business. Thus far, we have been able to get executed documents in place with approximately 30% of the eligible counterparties. We will have close to 100% eligible counterparties signed by the end of January.

## Generation Services

- Completed coal and rail transportation procurement for Lawrence/Tecumseh Energy Centers to accomplish fuel switching from Colorado coal to Montana coal. Montana coal was delivered starting the third quarter. By year 2000, this initiative will allow $10 to $15 million in annual fuel savings.

- As continued follow-up to the accident at Lawrence Energy Center, we developed and issued new standards for electrical safety related work practices for all the energy centers. In related work, we completed Job Hazard Analyses on Medium Voltage Electrical Equipment and on Coal Handling Equipment (fire hazards due to dust).

- Generation Services' accident incident rate is better than any recent year in our history; 4.1 accidents per 200,000 man-hours worked. Lost time accidents are only three for the year.

- A major inspection of the Hutchinson #4 80 MW combustion turbine was completed in 2½ weeks time this past summer. Unanticipated system demands had resulted in all the remaining unit starts allowed since the previous inspection being used by the end of June. The quick turnaround was critical because of the demands on the system this summer.

- During 1998 we began the process of returning the 67 MW Neosho Energy Center Unit 3 to service. This unit has been mothballed since early 1986. Inspection has revealed only minor deterioration of the system during this lengthy period in preservation. Restart is planned to allow operation on May 1, 1999, with a complement of 15 employees. When the station last operated in 1985, a total of 41 employees were on the Neosho roster.

- Cooling towers replaced in 1998 were Murray Gill Units 1, 2, and 3, and Gordon Evans Unit 2 (catastrophic failure last December). Cooling tower repair/replacement continues to be targeted to avoid unanticipated outages. These towers are original equipment, over 30 years of age.

- The Gordon Evans combustion turbine plant addition of 300 MW began in August and will continue through 2001. In addition, the Jeffrey wind power project began in early 1998. The demonstration phase of the project will begin in early 1999 when construction of the two units (1½ MW) is complete.

- Also, an 80 MW combustion turbine owned by the City of McPherson Board of Public Utilities was made available on December 1, 1998. Coupled with an agreement with the City of Erie for a 20 MW capacity addition, we have increased "peaking" purchases by 100 MW for the 1999 summer.

- Power Marketing kept the lights on despite some pretty terrible circumstances, including $7500/MWh power, new NERC transmission rules, the new marketplace and more than normal equipment outages. We continue to expand the scope of the trading operation by conducting transactions with more counterparties in other regions.

- Generation at Jeffrey Energy Center was hampered early in the year due to poor coal delivery. All three units ran well and posted good generation numbers despite these restrictions. The ongoing problems associated with the worn out economizers on Units 1 and 2 indicate their timely replacement in 1999 is warranted.

- Lawrence Energy Center overcame several major hurdles in 1998. Included was the startup of Unit 5 in January following the tragic fatality accident the previous November. Unit 5 was off line again in April and May for a turbine inspection and completion of the unit controls replacement. On June 28, the generator stator winding failed forcing the unit off line again for repairs. Rewind of the generator was completed in mid-October. Due to the nature and location of the failure, a complete rewind was required.

- Tecumseh Energy Center had a major storm related fire in the Unit 7/9 4160 volt station power Switchgear in mid-June. Virtually all the Switchgear and station power transformer were damaged requiring four weeks to repair.

- Wolf Creek operated the entire year without an outage. A refuel is scheduled to begin in April 1999.

<u>Regulatory/Environmental</u>

- Regulatory refiled the KCPL merger application with the KCC, MPSC, and FERC which reflected the restructured agreement, an updated merger savings estimate and a revised regulatory plan. To date, we have responded to over 1,000 separate requests for data from regulatory agencies and intervenors concerning the proposed merger with KCPL.

- We filed a Generation Siting Application on December 2, 1998, to obtain KCC approval to build two new 74 MW combustion turbines by June 1, 2000, and a 151 MW combustion turbine by June 1, 2001. A hearing schedule has been set.

- Although there were many tax issues, the most significant one affecting the Company this year was the Kansas Tax Reduction and Reform Act of 1998 (SB 493). The mill levy reduction from 27 to 20 mills will equate to a tax savings of nearly $5.8 million dollars for WR/KGE.

- We settled the Lawrence Energy Center OSHA case for $200,000. This is down from the proposed penalty of $485,000 and more importantly minimized the cost of compliance requirements through negotiation. There will not be any penalties or fines associated with the Allen Substation fatality.

- The Kansas History Center's Nature Trail was dedicated in Topeka and the Green Team was recognized for its lead role in the accomplishment. This is just one example of the continuing work we do within the community for which we have received excellent recognition.

Shared Services

- The end of 1998 marks three months of existence for the Shared Services organization.

- For the first time, Service Level Agreements (SLAs) have been prepared for each Shared Services budget area which outline basic services provided, budgeted costs, and service level measures. An activity tracking system has been developed and put in place so that we can track and manage our labor costs more effectively.

- Human Resources - we shifted our health program to FMH Benefit Services as our third party administrator along with Delta Dental. This resulted in costs $1 million below budget.

- An appeals conference was held with respect to the protest of issues raised by the Internal Revenue Service for the taxable years 1992, 1993, and 1994. The IRS proposed to increase taxable income by approximately $65 million. The IRS conceded approximately $54 million, which saved the Company $26 million in additional tax and interest.

- During 1998, Western Resources completed over three-quarters of our Year 2000 (y2k) project, developed company-wide contingency plans, established ongoing communications with our business affiliates (Protection One, Wolf Creek, KCPL and ONEOK), and provided y2k status information to the public through meetings, forums and other presentations.

- Major enhancements/upgrades were made to the Customer Service and Administrative/ Financial systems. Wolf Creek financials were converted to Western's financial system, a new Human Resources/Payroll system, Peoplesoft was implemented, and significant improvements were made in communicating with the business units and the priority setting process.

- Shareholder Value Added Model - Shareowner value added (SVA), a measurement of financial worth, was adopted by the Company in 1997. SVA is tracked and reported monthly for each of the business units. In 1998, the SVA model continued its evolutionary process.
- During 1998, 10 financial transactions totaling in excess of $3 billion have been completed for Western Resources and Protection One. These included: credit facility, shelf registrations, issuance of common stock, and issuance of a variety of notes.
- During 1998, we opened the parking garage at 800 Kansas and began moving Western Resources departments into the lower level of 800 Kansas, allowing two floors in the Santa Fe building to be opened.

TO: David Wittig

FROM: Carl Koupal

DATE: January 13, 1999

SUBJECT: Short-Term Incentive

CC:

Western Resources

INTERNAL CORRESPONDENCE

---

The following is a list of some key activities and achievements of 1998:

- Revamped the compensation philosophy of the company with a strong pay-for-performance approach. Restructured the exempt salary structure from 15 pay grades to 10.
- Began the coordination of human resources functions with Protection One and other companies to provide standardization and promote efficiencies.
- Changed our third-party administrator to FMH Benefit Services resulting in costs $1 million below budget.
- Worked to create and promote a positive image of the company with our constituencies -- shareholders, investment community, employees, customers, and communities we serve.
- Continued community involvement in various organizations including: Topeka Chamber of Commerce, United Way, Topeka Community Foundation and others.

CONFIDENTIAL

TO: David Wittig

FROM: Doug Lake (Ext. 6393)
11th Floor, Topeka G.O.

DATE: January 7, 1999

SUBJECT: 1998 Year End Review

CC:

Western Resources

INTERNAL CORRESPONDENCE

I wanted to summarize my principal accomplishments in 1998 since joining Western Resources on September 1st.

1. ***The Wing Group***

I am coordinating what I expect to be a successful exit from the international power development business. We are moving forward in closing down Wing Group operations on January 31st, including closing offices, terminating employees (with fair severance packages) and cutting off future development spending. Management of our operating projects in Colombia, China and Turkey are being transitioned to Topeka. I am in ongoing negotiations with Wing principals on a mutual settlement agreement. While the outcome of these negotiations are uncertain, I am confident that our separation will be managed as smoothly as possible.

2. ***Protection One***

I initiated in October, the process to push Protection One into the public bond market resulting in a successful bond offering in December. My role included getting Protection One management in front of the investment banking community and keeping the process on track through difficult market conditions in the high yield market.

3. ***Oneok***

I have been working with Oneok senior management on evaluating numerous merger and acquisition opportunities, including Columbia Energy and Southwest Gas. My role included providing guidance on strategy, valuation and market impact. In late December, Oneok announced a $1.8 billion acquisition of Southwest Gas which when completed will create the nation's largest pure play gas company with 2.6 million customers.

TO: David Wittig

FROM: Bill Moore

DATE: January 8, 1999

SUBJECT: 1998 Performance Review

CC: Carl Koupal

Western Resources

INTERNAL CORRESPONDENCE

---

My responsibilities continued to change in 1998.

As leader of the EDS team for 9+ months, we made significant progress toward becoming a financially driven/customer orientated organization. Additionally, we participated in the design of and implementation of restructuring the utility operations. This was done to provide the framework for the KCPL merger as well as competition in our industry. The attached performance report reflects the successful year for EDS in 1998 versus team goals. The EDS team is proud of its progress.

There has not been a dull moment since my move to Topeka as acting CFO. From Wing issues to P-1 financings issues, to financial forecasts and subsequent stock price and street reactions, the three months have passed quickly. The attached list provides the highlights for the tax, accounting and finance areas. Though my time with this group has been short, it is clear that they are also proud of their accomplishments, and the value added to Western Resources.

Since my appointment as CFO, I have been reducing my community involvement in Wichita. I intend, however, to continue to have a presence in Wichita and stay active on various boards such as Wichita State University Board of Trustees, WSU Endowment Association, budget and finance committee chairman (through mid-1999), Intrust Bank Board, Heartspring Board, and Wichita Chamber of Commerce Board (until Annette Beck assumes the Executive Committee position).

Please let me know if you have any questions regarding this information. I approach this new assignment with great enthusiasm. I appreciate the opportunity you have given me.

# 1998 FINANCE & ACCOUNTING ACCOMPLISHMENTS

## TAX

- Received favorable nuclear decommissioning trust ruling from IRS thereby enabling WR to claim deductions equal to customer collections.

- Split dollar life. Assisted in the implementation of the Executive Split Dollar Life Insurance Program which allows tax deferral on compensation.

- OKE stock redemption. Evaluated ONEOK's stock redemption plan and tax consequences to Western. Recommended delay of plan which preserved tax free nature of ONEOK transaction.

- Transfer pension and 401K to ONEOK. Coordinated the quantification and transfer of applicable pension and 401K fund balances to ONEOK.

- Changed trustee on pension and nuclear decommissioning trust which lowered administrative fee.

- Negotiated favorable IRS settlement of Audit years 92, 93 and 94 which resulted in Western saving $26.4 million in taxes and interest.

- Executed SWAP Agreement with Bear Stearns on Page Net stock which allows WR to take $12 million pre-tax loss in 1998 while still maintaining long position.

- Completed investment of $95 million in affordable Housing Tax Credit Program. This income is used to offset post retirement and post employment benefits.

## ACCOUNTING

- Implemented ONEOK shared service agreements (approximately 30). These agreements allow for the proper billing of costs between WR and OKE.

- Year 2000 testing essentially complete.

- Implemented Peoplesoft for payroll which gives HR a common data base.

- No Arthur Andersen audit adjustments.

- Converted Wolf Creek to AFS which makes Wolf Creek accounting Y2K compliant.

- Year End Balance Sheet clean-up and write offs. Coordinated with Arthur Andersen the evaluation and documentation of Western's non strategic investments, establishment of certain reserves, and true up of certain compensation plans resulting in approximately $135 million in write-offs.

- Converted to commercial format for financial statements from utility format.

- Implemented plain English writing for Western's MD&A one year in advance of SEC requirements.

- Timely filed all SEC and IRS documents.

- Completed ONEOK purchase price adjustment which resulted in $150 million in recovery for Western. This was resolved without litigation or arbitration.
- Converted Lotus SVA model to ESS Base (mainframe). This conversion eliminates maintenance and improves controls.

<u>FINANCE</u>
- The finance group participated and completed over $2.7 billion of fundings in 1998. In addition, there is $735 million of securities remaining on the shelf for future issuance.

- Raised $30 million through retail unsecured notes (6.8% coupon) with Edward D. Jones.

- Raised $400 million through 20 year put/call notes (6¼% coupon) with Warburg Dillon Reed.

- Completed revolving credit facilities totaling $800 million priced at LIBOR +25 bp consisting of $500 million five-year facility, and $300 million one-year facility.

- Completed conversion of financial model to PC based system which enables management to view fully consolidated financial statements and reflect minority interest accounting. This new system will reduce training time of future users by 75%.

- Worked in conjunction with Protection One staff to raise $1.5 billion through the following:

  1) $500 million revolver priced at LIBOR +125 Bp.
  2) $350 million subordinated note (8 1/8% coupon) with Morgan Stanley
  3) $250 million senior debt offering (7 3/8% coupon) with Bear Stearns
  4) $400 million equity offering priced at $9.50/share Morgan Stanley

Richard Terrill
Law Division
1998 Accomplishments

The Law Division provided legal advice and assistance on the following matters:

I. FINANCINGS:

1. $800 million Western Resource Credit Facility.
2. $30 million 6.8% Senior Notes.
3. $800 million Shelf Registration Statement.
4. $400 million 6.25% Senior Notes.
5. $72 million P1 Common Stock Public Offering.
6. $335 million P1 Ccommon Stock Private Placement.
7. $250 million 7.35% P1 Senior Notes
8. $350 million 8.125% P1 Notes.
9. $500 million P1 Credit Facility.
10. Sale of 13 5/8% P1 Notes held by Western.
11. Obtained FERC Short Term Borrowing Authority for $2 billion.

II. TRANSACTIONS:

1. Restructuring of KCPL Merger Agreement.
2. Prepared Special Meeting proxy and obtained shareholder approval of KCPL merger.
3. Acquisition of Multimedia Security.
4. Acquisition of CET.
5. Attempted Acquisition of KC Royals.
6. Acquisition of Small Dengfeng II.
7. Acquisition of Lifeline Systems, Inc.
8. Restructuring of investment in Guardian International.

III. HUMAN RESOURCES AND BENEFITS:

1. Law Division operated below budget.
2. Law Division reorganized resulting in elimination of 3 attorney positions, 3 exempt positions and one clerical position.
3. Settlement of IBS Litigation.
4. Wing Group and foreign investment activities.
5. Obtained market based wholesale rate authority.
6. Acquisition of aircraft.
7. Development of power marketing risk management policies and power marketing contracts.
8. KCC approval of KPL/KGE merger savings.

## SHORT TERM INCENTIVE

RESOLVED, that the executive officers of the Company receive short term bonuses for the year ended 1998 in accordance with the Company's Short Term Incentive Plan as presented to the meeting; and further

RESOLVED, that the officers of the Company be, and hereby are, authorized to take such actions as they may deem necessary or appropriate to carry out the foregoing resolution.

C

# 1999 Option & Restricted Share Grants

| Officer | PG | # of Employees | Total Options | Restricted Shares |
|---|---|---|---|---|
| David Wittig | 1 | 1 | 113,000 | 42,000 |
| Douglas Lake | 4 | 1 | 30,000 | 13,500 |
| Carl Koupal | 5 | 1 | 28,000 | 13,000 |
| Richard Terrill | 7 | 1 | 9,000 | |
| William Moore | 7 | 1 | 12,000 | |
| Thomas Grennan | 7 | 1 | 12,000 | |
| Rita Sharpe | 9 | 1 | 8,000 | |
| James Martin | | | | |
| Annette Beck | | | | |
| Wayne Kitchen | | REDACTED | | |
| Carl Ricketts | | | | |
| Leslie Morgan | | | | |
| Douglas Henry | | | | |
| Jo Hunt | | | | |
| | A | 10 | 27,650 | |
| | B | 21 | 49,600 | |
| | C | 53 | 125,640 | |
| | D | 105 | 67,140 | |
| | DD | 48 | 17,040 | |
| | E | 115 | 35,030 | |
| | F | 92 | 19,380 | |
| | G | 91 | 14,810 | |
| | H | 51 | 6,370 | |
| | I | 65 | 5,500 | |
| | Nonexempt | 237 | 20,830 | |
| | Total Option or Shares | | 642,690 | 68,500 |

# LONG TERM INCENTIVE AND SHARE AWARD PLAN

RESOLVED, that the officers of the Company be, and hereby are, authorized to grant Stock Options, Dividend Equivalents, Restricted Shares and Restricted Share Units as presented at the meeting; and further

RESOLVED, that the officers of the Company be, and hereby are, authorized to take such actions as they may deem necessary or appropriate to carry out the foregoing resolution.

D

# Stock Compensation Program

January 27, 1999

Western Resources

# Stock Compensation Program

Objectives

- Strengthen link between individual reward and company performance.
- Increase stock ownership by senior management.

Western Resources

# Stock Compensation Program

Key Characteristics

- Portion of compensation paid in the form of stock (restricted share units).
- Number of shares determined on the basis of market value of common stock, discounted 15%.
- Proportion of cash vs. stock is determined through a formula applied to all compensation increases.

Western Resources

# Stock Compensation Program

Key Characteristics

- At the time of grant, employee determines deferral period (no less than 3 years).
- Dividends paid in cash or reinvested, at employee election.
- Common stock is issued to the employee at the end of the deferral period.

Western Resources

# Stock Compensation Program

## Formula

| Total Base Comp. | Stock % | Stock at Max. |
|---|---|---|
| 0-50,000 | 2.5% | $1,250 |
| 50,000-75,000 | 10% | $3,750 |
| 75,000-100,000 | 15% | $7,500 |
| 100,000-150,000 | 25% | $20,000 |
| 150,000-250,000 | 50% | $70,000 |
| Greater than 250,000 | 75% | - |

Example: Base = $106,000

Stock Requirement = 9,000 (7,500 + (.25 x 6,000)

Western Resources

# Stock Compensation Program

- Program would be phased-in over a three year period. The formula would apply only to increases in compensation.

- Program for the first year applies to officers and senior management in Grades A and B. This is the top 46 employees of the company.

- Any officer could participate to the full amount of the formula beginning in year one.

Western Resources

# AMENDMENTS TO BENEFIT PLANS

RESOLVED, that the officers of the Company be, and hereby are, authorized to amend the Company's benefit plan to take into account restricted share units in determining compensation under the plans unless prohibited by applicable law or regulation; and further

RESOLVED, that the officers of the Company be, and hereby are, authorized to take such actions as they may deem necessary or appropriate to carry out the foregoing resolution.

E

# 401(k) Company Match

January 27, 1999

Western Resources

# 401(k) Company Match

- Company currently matches 401(k) contributions .50 cents in cash for every $1 up to 6% of employee's base and incentive earnings

- This proposal would match, at the same rate, in new issued Western Resources common stock

- Effective April, 1999 for all non-union employees
  - Negotiate with union for mid-year

- According to Vanguard, approximately 70% of companies now provide match in stock

Western Resources

# 401(k) Company Match

- The match must be retained as stock until age 55
  - Same as KCPL

<u>Objectives</u>

- Tie interests of employees with the company
- Raises equity

Western Resources

# AMENDMENTS TO 401(k) PLAN

RESOLVED, that the officers of the Company be, and hereby are, authorized to amend the Company's 401(k) Plan to allow for the Company matching contributions to be in the form of common stock; and further

RESOLVED, that the officers of the Company be, and hereby are, authorized and empowered, on behalf of the Company, to prepare, execute and file with the State Corporation Commission of the State of Kansas and the Federal Energy Regulatory Commission an application or applications and any and all necessary amendments, exhibits and other documents related thereto, for the purpose of obtaining such authorizations as may be necessary for the Company to register and transfer Common Stock pursuant to the Plan; and further

RESOLVED, that the Chairman of the Board and Chief Executive Officer, or any Vice President and the Secretary of the Company, be, and each hereby is, authorized and empowered to cause the company to apply to the New York Stock Exchange ("Exchange") for the listing of the additional Common Stock and further that each such officer and any other officer of the Company be, and hereby is, designated to appear before the appropriate officials of said Exchange with authority (a) to execute in the name and on behalf of the Company and file with the Exchange an appropriate listing application and all such agreements and documents (including an indemnity agreement) as any of them may consider necessary or desirable to secure such listing, and (b) to make any changes in such listing application or agreements or documents as may be required to satisfy the requirements of the Exchange for such listing; and further

RESOLVED, that it is desirable and in the best interest of the Company that its securities be qualified or registered for sale in various states; that the Chairman of the Board and President or any Vice President and the Secretary or an Assistant Secretary hereby are authorized to determine the states in which action shall be taken to qualify or register for sale all or such part of the securities of the Company as said officers may deem advisable; that said officers are hereby authorized to perform on behalf of the Company any and all such acts as they may deem necessary or advisable in order to comply with the applicable laws of any such states, and in connection therewith to execute and file all requisite papers and documents, including, but not limited to, applications, reports, surety bonds, irrevocable consents and appointment of attorneys for service of process; and the execution by such officers of any such paper or document or the doing by them of any act in connection with the foregoing matters shall conclusively establish their authority therefore from the Company and the approval and ratification by the Company of the papers and documents so executed and the action so taken; and further

RESOLVED, that the officers of the Company be, and hereby are, authorized to take such actions as they may deem necessary or appropriate to carry out the foregoing resolutions.

F

# LONG TERM INCENTIVE AND SHARE AWARD PLAN

RESOLVED, that the officers of the Company be, and hereby are, authorized to amend outstanding stock options, dividend equivalents, and restricted share grants as presented at the meeting; and further

RESOLVED, that the officers of the Company be, and hereby are, authorized to take such actions as they may deem necessary or appropriate to carry out the foregoing resolution.

G

# CAPITAL GAIN INCENTIVE COMPENSATION PLAN

RESOLVED, that the officers of the Company be, and hereby are, authorized to establish a Capital Gain Incentive Compensation Plan as presented to the meeting; and further

RESOLVED, that the officers of the Company be, and hereby are, authorized to present the plan to the shareholders of the Company for approval in accordance with Internal Revenue Code §162(m); and further

RESOLVED, that the officers of the Company be, and hereby are, authorized to take such actions as they may deem necessary or appropriate to carry out the foregoing resolutions.

H

# SHORT TERM INCENTIVE PLAN

RESOLVED, that the officers of the Company be, and hereby are, authorized to amend the Company's Short Term Incentive Plan to establish a maximum payment under the plan of four times annual compensation and to separate the discretionary component of the plan into a separate discretionary short term incentive plan; and further

RESOLVED, that the officers of the Company be, and hereby are, authorized to submit the Company's Short Term Incentive Plan, as amended, to the Shareholders for approval in accordance with Internal Revenue Code Regulation 162(m); and further

RESOLVED, that the officers of the Company be, and hereby are, authorized to take such actions as they may deem necessary or appropriate to carry out the foregoing resolutions.

# *Western Resources, Inc.*

## Presentation to the
## Human Resources Committee

January 27, 1999

Deloitte & Touche

# *Table of Contents*



Deloitte & Touche



WS030345

# *Background*

- Western Resources, Inc. ("WR" or "the Company") asked Deloitte & Touche to review and provide recommendations on various components of the Company's compensation program
- Several of the contained issues were raised at the November 18, 1998 Human Resources Committee meeting and at that time the Committee asked that Deloitte & Touche provide recommendations on the issues
- The following contains the competitive information previously presented to the Committee and the accompanying Deloitte & Touche recommendations

# *Structure of LTIs*

- Currently, WR has various performance hurdles and time constraints that must be met before employees earn their long-term incentive awards/stock options
- It has been noted in recent recruiting efforts that the long-term incentive plan at WR is difficult to understand and even more difficult for an executive to track performance
- The following page highlights some of the mechanics of WR's current long-term incentive awards

# Structure of LTIs

- Stock options
  - cliff vest at the end of year three
  - vesting is contingent upon 20% stock price appreciation from the date of grant
- Dividend Equivalent Rights (DERs)
  - restricted to five-years of accumulation, while the option has a 10-year life
  - subject to the same stock price appreciation goals as the options
  - a performance hurdle must be met whereby the DER payout is adjusted based on the Company's TSR performance in comparison to its peers, yet the peer group for prior years' grants has been modified
- Restricted Stock Awards (RSAs)
  - cliff vest at the end of year four if 20% stock price appreciation is achieved

# *Structure of LTIs*

**Analysis**

- In order to determine how WR's long-term incentive awards compare with those of their peers, we analyzed the long-term incentive plans in the proxy statements of each of the peer companies
- We focused on the manner in which the awards vest including if vesting is contingent upon the achievement of various performance hurdles
- The appendix provides the detail of the stock option and restricted stock award provisions for each of the peer companies (where data was available)

# *Structure of LTIs*

**Stock Option Findings**

- Based on the peer data available, only 10% of the peer companies cliff vest executive stock option awards
- Seventy-four percent of the companies vest executive stock options in three years or less
- Only fourteen (14%) percent of the peer companies make the vesting of stock options contingent on performance hurdles. The performance requirement is redundant because no one would exercise an option below market

**Conclusion**

- Based on these analyses, it appears that WR stock options have much more stringent measures associated with the award

# *Structure of LTIs*

**Stock Option Recommendation**

- We recommend that Western Resources modify the provisions of the Company's stock option awards as follows:
  - Remove the stock price appreciation hurdle since the nature of stock option awards drives stock price appreciation
  - Vest the awards ratably over the three year period (i.e., 33% per year over three years)
- The above recommendations position the compensation packages of WR more competitively with the external market, better positioning the Company to attract and retain key talent

# *Structure of LTIs*

**DER Findings**

- WR executive options do not vest ratably but rather vest at the end of a period which is longer than that used by the Company's peers and the vesting of the options is contingent upon performance criteria
- The Company's DERs are also contingent upon performance which was noted by only one of the peer companies
- None of the peer companies indicated that DERs accumulate for a limited number of years

**Conclusion**

- Once again, WR's DERs are more difficult to earn than DERs earned among the Company's peers

# *Structure of LTIs*

**DER Recommendations**

- We recommend that WR modify the provisions on the DERs as follows:
  - Eliminate the five year restriction on the accumulation of dividends and allow the dividends to accumulate over the term of the option
  - Link the vesting and payout of dividends to stock price appreciation rather than TSR in comparison to WR's peers to provide simplification
  - Vest the DERs upon the achievement of the share price remaining at or above 120% of the exercise price for 30 consecutive trading days but no earlier than one-third per year

# *Structure of LTIs*

**Restricted Stock Award Findings**

- Fifty (50%) percent of the peer companies which utilize RSAs cliff vest the award
- Seventy-one (71%) of the peers have a vesting schedule which is 3 years or less for RSAs
- The vesting of awards was contingent upon the achievement of performance in forty-two (42%) percent of the organizations

**Conclusion**

- WR's vesting schedule for restricted stock awards is longer than what most of the peer companies are utilizing and it also is a cliff vest
- Not only is the timing of WR's awards longer than the peers, performance hurdles must also be met

# *Structure of LTIs*

**Restricted Stock Award Recommendation**

- In order to provide WR a greater ability to recruit and retain executive talent through RSAs, we recommend that the Board consider the following modifications:
  - Modify the performance hurdle whereby vesting is accelerated by meeting corporate goals, not contingent upon their achievement
  - Vest the award on the earlier of the 9th anniversary of the date of grant or the date in which share price remains at or above 120% of the grant price for 30 consecutive trading days, but not earlier than the fourth anniversary of the date of grant
  - Changing the award to be accelerated rather than contingent upon performance modifies the accounting implications so that the charge to earnings is not variable but rather fixed at the date of grant

# *Dealing with One-Time Gains*

**Analysis**

- In 1997, WR faced a situation in which a large "one-time" capital gain occurred through the existing short-term incentive program
- In order to alleviate both the Company and the Board from having to hastily act on a similar situation, WR has asked that Deloitte & Touche consider alternatives for dealing with additional "one-time" type capital gains
- Companies typically consider various alternatives to making large cash payments under similar circumstances including paying out a portion of the incentive in stock or providing additional benefits to the executive such as life insurance

# *Dealing with One-Time Gains*

**Recommendation**

- After our review of alternatives in the marketplace, Deloitte & Touche recommends the following proposal be considered:
  - Utilize the difference in the short-term incentive award including the capital gain and the short-term incentive award not inclusive of the capital gain to purchase a split dollar life insurance policy for the executive
  - In performing this calculation, capital gains/losses should be defined as:
    - Non-operating earnings including gains/losses from asset sales or holdings
    - These gains should only include those not budgeted
    - Things such as lawsuit settlements, increases in COLI, etc. should not be included

# *Dealing with One-Time Gains*

**Recommendation (continued)**

- Under the policy, the Company would be reimbursed for the premium and the cost of money at 6%
- Any capital losses would carry forward for two years to offset any gains

• Essentially, the above recommendations are of no cost to the Company since under the policy the Company will be reimbursed for the premium and the cost of money

• Additionally, the Company is further protected in years in which there is a capital loss because the executives will not earn any incentive related to future capital gains until they are in excess of the losses

# *Short-term Incentive Plan - 162(m)*

- Section 162(m) of the Internal Revenue Code dictates that compensation paid to the top five highest paid officers in a publicly-traded organization that is in excess of $1 million is not deductible unless it is performance-based
- In order for any payment under the short-term incentive plan to qualify as performance-based, many provisions must be adhered to including the following:
  - the Plan must be governed by a compensation committee that is made up of at least two outside directors
  - The performance goals and other material terms of the arrangement under which the performance-based compensation is to be paid must be disclosed to shareholders and approved by a majority of the shareholders prior to the payment of the compensation

Deloitte & Touche

# *Short-term Incentive Plan - 162(m)*

- The material terms under which compensation is to be paid include:
  - the employees eligible to receive compensation (a general description of the class or titles of employees is sufficient)
  - a description of the business criteria on which the performance goals are based (business criteria, not specific targets, are appropriate)
  - the compensation payable under a performance goal so that shareholders can determine the maximum amount of compensation payable to any employee during a specified period
- Upon approval of the Plan by the Board and shareholders, no additional disclosure or approval is required unless the Human Resources Committee retains the ability to change the material terms of the performance goals

# *Short-term Incentive Plan - 162(m)*

**Recommendations**

- The Plan should clearly specify its governing body to ensure that deductibility is not forfeited on an administrative issue
- A maximum dollar amount payable under the Plan for each participant must be established -- Deloitte & Touche recommends that the cap be established using a multiple equal to 4 times the highest current base pay or $2.8 million
- This cap would apply to all of the top five highest paid officers
- If the HR Committee retains the discretion to change the material terms of the performance targets, the targets must be re-approved by shareholders at least every 5 years

# *Appendix*

## Peer Company Long-Term Incentive Plans

# Stock Options

## Analysis (continued)

| Company Name | Stock Options (Y or N)* | Vesting Schedule | Performance Criteria |
|---|---|---|---|
| Air Touch Communications | Y | - One-fifth per year beginning on the second anniversary of the date of grant<br>- Ratably over three year period beginning on the date of grant | None |
| Alltel Corp. | Y | Not specified | Not specified |
| Borg Warner Security | Y | - One-half per year on the second and third anniversaries of the date of grant | None |
| Central and Southwest | N | | |
| CiNergy Corp. | Y | - Ratably over three year period beginning on the date of grant | None |
| Citizens Utilities Co. | Y | - Ratably over three year period beginning on the date of grant | None |
| CMS Energy Corp. | Y | Not specified | Not specified |
| Columbia Energy Group | Y | - Ratably over three year period beginning on the date of grant | -TSR (stock price appreciation plus dividends) in relation to peer companies |
| Dominion Resources Inc. | N | | |
| Duke Energy Corp. | N | | |
| Edison International | Y | - Ratably over three year period beginning on the date of grant | - No measures need to be met for options to become exercisable, but DERs are not payable until after the third anniversary at which time the Company's TSR performance is measured against its peers and dividends are paid accordingly |
| Entergy Corp. | Y | - Fully vest six months from the date of grant | None |
| Frontier Corp. | Y | - Ratably over three year period beginning on the date of grant | None |

Deloitte & Touche



WS030363

# Stock Options

## Analysis (continued)

| Company Name | Stock Options (Y or N) | Vesting Schedule | Performance Criteria |
|---|---|---|---|
| Houston Industries | Y | - Ratably over three year period beginning on the date of grant | None |
| KN Energy | Y | - Ratably over five year period beginning on the date of grant | - Vesting is contingent upon performance criteria not defined in the proxy |
| New Century Energies | Y | - Ratably over three year period beginning on the date of grant | None |
| NIPSCO Industries | Y | - Fully vest on the first annivesary of the date of grant | None |
| Northern States Power Co. | Y | - Fully vest on the first annivesary of the date of grant | None |
| Pacific Enterprises | Y | - Ratably over three year period beginning on the date of grant | None |
| Paging Network Inc. | Y | - Ratably over three year period beginning on the date of grant<br>- Fully vest on the date of grant | None |
| Pittston Co. | Y | - Cliff vest on the third anniversary of the date of grant | None |
| Sonat Inc. | Y | - Ratably over five year period beginning on the date of grant | None, but the size of the award is based on corporate TSR performance in comparison to the Company's peers |
| Southern Co. | Y | - Ratably over four year period beginning on the date of grant | None |

Deloitte & Touche



WS030364

# Stock Options

## Analysis (continued)

| Company Name | Stock Options (Y or N) | Vesting Schedule | Performance Criteria |
|---|---|---|---|
| Teco Energy Corp. | N | | |
| Texas Utilities Co. | N | | |
| Utilicop United Inc. | Y | - 25% of the award vests on the second and third anniversaries of the date of grant and the remaining 50% vests on the fourth anniversary | None |
| Valero Energy Corp. | Y | - Ratably over three year period beginning on the date of grant | None |
| Williams Companies | Y | - Cliff vest on the fifth anniversary of the date of grant with ability to accelerate the vesting based on stock price performance | None |

# Restricted Stock Awards

## Analysis (continued)

| Company Name | Restricted Stock (Y or N) | Vesting Schedule | Performance Criteria |
|---|---|---|---|
| Air Touch Communications | Y | - Ratably over two years | None |
| Alltel Corp. | N | | |
| Borg Warner Security | N | | |
| Central and Southwest | N | | |
| CINergy Corp. | Y | - Cliff vest at the end of year 3 | Contingent on TSR performance in relation to the Company's peers |
| Citizens Utilities Co. | N | | |
| CMS Energy Corp. | Y | - Ratably over four years beginning on the second anniversary of the date of grant | Contingent on the achievement of a 15% annualized total shareholder return |
| Columbia Energy Group | Y | - Ratably vest on the first five anniversaries of the date of grant | None |
| Dominion Resources Inc. | Y | - 100% at the end of year 1 | Preestablished growth goals must be met for the awards to vest |
| Duke Energy Corp. | N | | |
| Edison International | N | | |
| Entergy Corp. | N | | |
| Frontier Corp. | Y | - Ratably over three years beginning on the first anniversary of the date of grant | Predefined contribution levels to the long-term strategic goals of the organization must be met |
| Houston Industries | Y | - Cliff vest on the second anniversary of the date of grant | None |
| KN Energy | Y | - 20% per year over five years beginning on the date of grant | None |

# Restricted Stock Awards

## Analysis (continued)

| Company Name | Restricted Stock (Y or N) | Vesting Schedule | Performance Criteria |
|---|---|---|---|
| New Century Energies | N | | |
| NIPSCO Industries | Y | - Cliff vest at the end of year 2 with an additional two year holding requirement | Vesting is contingent on the achievement of nonfinancial performance criteria |
| Northern States Power Co. | Y | - 50% on the first anniversary of the date of grant and the remaining 50% on the third anniversary | Contingent on the Company's three year average return on equity equaling the median ROE on the EEI 100 Index |
| Pacific Enterprises | N | | |
| Paging Network Inc. | N | | |
| Pittston Co. | N | | |
| Sonat Inc. | Y | - Cliff vest on the tenth anniversary of the date of grant | Vesting can be accelerated if the stock price increases to specified levels |
| Southern Co. | N | | |
| Teco Energy Corp. | Y | - Cliff vest on the third anniversary of the date of grant | None |
| Texas Utilities Co. | N | | |
| Utilicop United Inc. | Y | - Cliff vest on the third anniversary of the date of grant | None |
| Valero Energy Corp. | N | | |
| Williams Companies | Y | - Cliff vest on the third anniversary of the date of grant | None |

Deloitte & Touche



WS030367

<u>Human Resources Committee</u>

Mr. Chairman, the Human Resources Committee of the Board met earlier this afternoon and reviewed a number of items.

The Committee reviewed the plan results for the 1998 short-term incentives for the officers. Payouts were approved by the Committee under the plan. Since the financial components of the plan were <u>not</u> achieved, the payouts for senior management were limited to the discretionary component of the short-term plan.

The Committee also approved granting stock options to senior management and officers at the same level as the 1998 stock options. In addition, the Committee approved certain recommendations made by Deloitte & Touche Performance Management Compensation Group modifying some of the provisions of prior long-term incentive grants.

The Committee also reviewed the proposal to pay officers, as well as employees in pay grades A & B, a portion of their base pay in company stock. **In order to include this portion of salary as pensionable pay,**

**the Committee has recommended a resolution allowing officers to amend various plans, such as the pension plan.**

Also reviewed and recommended for Board action is a proposal to provide the company's match in the 401(k) plan in common stock. Mr. Chairman, that resolution requires Board action and is found behind Exhibit 6 in your Board books.

Deloitte & Touche also presented a recommendation concerning possible "one-time" capital gains. This plan is in order to alleviate a situation similar to what occurred in 1997. The Committee reviewed the Deloitte & Touche recommendation and recommends to the Board a proposal that would work as follows:

The amount of the capital gain would be determined using a formula similar to our current short-term incentive award. In performing the calculation, capital gains/losses would be determined as those which were not budgeted but would not include things such as lawsuit settlements, increases in COLI, etc. This amount for the executives would be used to purchase an insurance policy. Under the policy the company would be reimbursed for the premium and the cost of funds. Mr. Chairman, an appropriate resolution for the Board on this matter is found behind Exhibit 6 which I move at this time.

In order for the payments under our short-term incentive plan to be deductible, any amount over $1 million must meet the following test:

- The plan must be governed by a compensation committee that is made up of at least two outside directors;
- The performance goals must be disclosed and shareholders must approve this performance measure.

The Committee recommends that our current short-term incentive plan be submitted to the shareholders for purposes of deductibility under section 162(m) and to amend the plan to provide the discretionary portion through a separate plan. An appropriate resolution is found behind Exhibit 6.

Mr. Chairman, that concludes the business of the Human Resources Committee. Thank you very much.