Exhibit No.:
Issue: *Incentive Compensation*
Witness: *Janis E. Fischer*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
Case No.: *EC-2002-1*
Date Testimony Prepared: *June 24, 2002*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

JANIS E. FISCHER

UNION ELECTRIC COMPANY
d/b/a AMERENUE

CASE NO. EC-2002-1

Jefferson City, Missouri
June 2002

**** Denotes Proprietary Information ****

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

The Staff of the Missouri Public Service Commission,		
	)	Case No. EC-2002-1
Complainant,	)	
vs.	)	
	)	
Union Electric Company, d/b/a AmerenUE,	)	
	)	
Respondent.	)	

AFFIDAVIT OF JANIS E. FISCHER

STATE OF MISSOURI
) ss.
COUNTY OF COLE)

Janis E. Fischer, is, of lawful age, and on her oath states: that she has participated in the preparation of the following Surrebuttal Testimony in question and answer form, consisting of 20 pages to be presented in the above case; that the answers in the following Surrebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Janis E. Fischer
Janis E. Fischer

Subscribed and sworn to before me this 27th day of June, 2002.

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

Toni M Charlton
Notary Public

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

TABLE OF CONTENTS OF

SURREBUTTAL TESTIMONY OF

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SURREBUTTAL TESTIMONY

OF

JANIS E. FISCHER

UNION ELECTRIC COMPANY

d/b/a AMERENUE

CASE NO EC-2002-1

Q. Please state your name and business address.

A. Janis E. Fischer, P.O. Box 360, Suite 440, Jefferson City, Missouri 65102.

Q. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor with the Missouri Public Service Commission (Commission).

Background of Witness

Q. Please describe your educational background.

A. I graduated from Peru State College, Peru, Nebraska and received a Bachelor of Science degree in Education (Basic Business) and Business Administration. In May 1985, I completed course work and earned a Bachelor of Science degree in Accounting. I passed the Uniform Certified Public Accountant examination in May 1994 and received my license to practice in March 1997. Prior to my employment at the Commission, I worked over six years as the office and accounting supervisor for the Falls City, Nebraska Utilities Department (Utilities Department).

While with the Utilities Department, I completed water and electric rate reviews, developed procedures for PCB monitoring and disposal, implemented a program to verify the accuracy of remote water meters, supervised office staff and handled customer complaints. I assisted with the acquisition of Falls City's natural gas distribution system from Kansas Power and Light Company, predecessor company of Western Resources, Inc. After the acquisition, I compiled asset records for the natural gas distribution system for the utility, nominated gas supplies for the municipal power plant, monitored gas transportation customer loads and billed transportation customers. I was appointed by the Board of Public Works (Board) to the Nebraska Public Gas Agency (NPGA) Board and later was elected Vice Chairperson of the Board. NPGA is comprised of members from municipal natural gas systems who collectively purchase natural gas and acquire natural gas wells to supply gas to municipal gas systems and power plants at reduced costs.

I also was employed as a staff accountant with the accounting firm of Cuneo, Lawson, Shay and Staley, PC, in Kansas City, Missouri, for approximately two years. While employed as a staff accountant, I assisted in various audits, compilations and reviews of corporations and prepared individual and corporate state and federal tax returns. I researched tax issues, assisted with compliance audits and interacted with various clients.

Q. What has been the nature of your duties with the Commission?

A. I have directed and assisted with various audits and examinations of the books and records of public utilities operating within the state of Missouri under the jurisdiction of the Commission.

Q. Have you previously filed testimony before this Commission?

A. Yes. Please refer to Schedule 1, attached to this surrebuttal testimony, for a list of the major audits on which I have assisted and filed testimony.

Purpose of Testimony

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

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of Union Electric Company, d/b/a AmerenUE (UE or Company) witnesses Mark C. Lindgren and David Cross, specifically related to the issue of incentive compensation expense.

Q. Are you adopting any of the direct testimony sponsored by the Staff in this proceeding?

A Yes, I am. Due to his surgery, I am sponsoring the portion of the direct testimony of Staff Accounting witness Doyle L. Gibbs that concerns the issue of incentive compensation. Other Staff witnesses will be adopting the other portions of Mr. Gibbs' direct testimony.

<u>INCENTIVE COMPENSATION</u>

<u>Description of Incentive Plans</u>

Q. Please describe the incentive compensation plans of UE.

A. The following is a description of the incentive plans for 2000, which governed incentive payments made in 2001 that occurred during the test year for this case:

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<u>The Staff's Position</u>

Q. Mr. Lindgren, on pages four through eight of his rebuttal testimony, discusses the changes that Ameren has made to its incentive plans since the 1998 implementation of a new performance management process called the "performance scorecard." Is it relevant to the determination of cost of service in this case to discuss the changes occurring in the 2001 and 2002 to Ameren's incentive plans?

A. No. The Commission ordered the use of a test year for this case that ends June 30, 2001, updated through September 30, 2001. This requires the Staff to evaluate the incentive plans that were effective during that period.

Use EPS as Trigger for Incentive Awards

Q. How would you respond to Mr. Lindgren's statement on page 10, lines 14-17, of his rebuttal testimony, "The incentive plans are structured to serve the best interests of both ratepayers and shareholders. As such, EPS is used to indicate the collective performance of Ameren compared to shareholder expectations and then fund the incentive plan in relation to this performance."?

A. UE states that the level of EPS determines the availability of additional money to pay incentive compensation. However, the Staff is opposed to including in rates costs associated with any incentive plan that determines the overall payout, or individual payouts, based upon an EPS trigger in a utility company's revenue requirement. There is no direct link between increased earnings of a utility company and benefits to ratepayers. EPS is a performance indicator that better expresses benefits to shareholders. In UE documents given to employees discussing incentive compensation plans, the repeated emphasis is on performance to benefit shareholders and increased profits rather than on improving service to customers.

Q. Why isn't an EPS "trigger" for payment of incentive compensation appropriate from a ratepayer perspective?

A. There are several reasons why the use of an Ameren EPS level to determine incentive compensation payouts is not appropriate. The calculation of EPS is based upon the performance of Ameren in total and does not differentiate between utility jurisdictions or regulated versus non-regulated activities. This basis promotes actions that would promote Ameren's profitability at the expense of UE and its customers. Staff witness, Michael. S. Proctor, of the Energy Department, provides an example of how UE's interests are subjugated to promote Ameren's profitability in his discussion regarding the "Joint Dispatch Agreement."

EPS is merely a quotient calculated by taking the net income of Ameren in total and dividing by the number of common shares outstanding. The increases and decreases to EPS are the result of fluctuations in expenses, revenues and the number of shares outstanding. Each of these components of EPS can be affected by any number of factors, some of which are within management's control and some which are not. Ameren's 2001 Annual Report to Shareholders, at page 15, lists factors that contributed to changes in EPS between 1999 and 2001:

> Earnings and earnings per share increased over the three-year period primarily due to: the rate of sales growth, weather variations, credits to electric customers, electric rate reductions, gas rate changes, competitive market forces, fluctuating operating costs (including Callaway Nuclear Plant refueling outages), expenses relating to the withdrawal from the electric transmission related Midwest Independent System Operator (Midwest ISO), charges for coal contract terminations, adoption of a new accounting standard, changes in interest expense, and changes in income and property taxes.

Earnings measures, such as EPS, do not necessarily reflect customer interests. While some of the factors listed above directly impact ratepayers if rates are reduced, one cannot conclude that other factors resulting in EPS changes over the last three years even indirectly represent improved customer service or benefits. ** P

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P ** If shareholders are the ones to benefit, they should be the ones who pay. If incentive compensation plan goals are financially driven there is a risk that they may be achieved at the expense of customer service.

Q. Isn't it true that EPS promote efficiency?

A. Yes. It also promotes actions to make sure any efficiency gains are not passed on to consumers that would lower EPS. This is shown in testimony of some of AmerenUE's witnesses supporting their Alternative Regulatory Plan (ARP).

Q. How did UE's EPS payout trigger amount compare to UE's budgeted income levels?

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> At a minimum, an acceptable management performance plan should contain goals that improve existing performance, and the benefits of the plan should be ascertainable and reasonably related to the incentive plan.

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In addition, by including the incentive awards in cost of service, the Commission will be guaranteeing that the funds are available through a normalized revenue stream. The UE incentive compensation plans have changed every year. There is no guarantee that costs the Commission would find acceptable one year would be continued in future years.

Q. Mr. Lindgren on page 2 of his rebuttal testimony states, “It is improper to deny recovery of costs associated with the Company’s Incentive Compensation Program.” Is recovery of costs in rates the only way a utility can fund incentive compensation plans?

A. No. Incentive compensation goals that result in efficiencies, expense reductions and revenue increases provide additional funds that should be used to fund the payouts to employees that contributed to the financial goals being met. In addition, goals that are directed towards shareholder benefits should be funded through shareholder contributions. Other incentive compensation goals directed towards improved customer service typically would not have positive monetary impacts, and payouts to employees for attaining these goals should be paid by ratepayers since they directly benefit.

Q. Mr. Cross on page 11, lines 8-10 of his rebuttal testimony states, “According to our surveys, earnings based incentive measures are among the most common across the industry.” Does this mean that if other utility companies find the use of EPS to be acceptable that the Missouri Commission should include costs associated with the incentive plans in utility company revenue requirements?

A. No. In fact a recent Illinois Commerce Commission decision in 00-0802, 214 PUR4th 437, Re Central Illinois Public Service Company (AmerenCIPS) states:

> With regard to the requested level of expenses under Ameren's plan, the actual payout to employees pursuant to the plan will not occur unless earnings per share targets are achieved. Therefore, although Ameren's incentive compensation plan does include certain performance and efficiency goals, no funding of the plan will occur and no incentive payments will be made if the Company fails to meet its financial target, even if all key performance indicators are met by the employees. Meanwhile, under the Company's proposal, the projected payouts would continue to be collected from ratepayers even if actual payouts do not occur…Accordingly, while the commission believes that incentive compensation plans have the potential to provide benefits in terms of improving performance and reducing costs, and that the recovery of expenses associated with incentive compensation plans may be appropriate in some circumstances, the Commission concludes, for the reasons set forth above, that Ameren should not be allowed to recover from ratepayers the expenses associated with its current incentive compensation plan as requested in this docket.

Q. How does Ameren convey its incentive compensation "focus" for the coming year to its employees?

A. The CEO, Mr. Charles Mueller, drafts a letter tailored specifically for each group of employees covered under the AIP, AMIP and EIP. Excerpts from the February 14, 2000 letter to AIP employees states:

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A. No. The EPS results reflect overall performance of Ameren, including all subsidiaries. Non-Missouri and non-regulated operations combined with Missouri operations are included in the EPS that determines incentive compensation payouts.

Q. Has the Commission addressed this issue related to the use of non-Missouri specific earnings results in determining incentive compensation awards in prior cases?

A. Yes. In Case Nos. TC-89-14, et al., respecting Southwestern Bell Telephone Company (SWB), a regulated subsidiary of Southwestern Bell Corporation (SBC) the Commission's Report and Order states:

> In the Commission's opinion the results of the parent corporation, unregulated subsidiaries, and non-Missouri portions of SWB, are only remotely related to the quality of service or the performance of SWB in the state of Missouri. Achieving the goals of SBC and unregulated subsidiaries is too remote to be a justifiable cost of service for Missouri ratepayers.

Q. Why is it not appropriate to set Missouri utility rates based upon costs of service resulting from non-Missouri specific earnings results?

A. By using EPS for the measurement of the level of payout available to employees, the performance of activities that Ameren engages in may be irrelevant to or even contrary to the interests of Missouri ratepayers but may increase incentive compensation payouts. Increased profits in marketing of power or performance of AmerenCIPS could increase EPS and incentive compensation payouts without any improved performance that benefits ratepayers in Missouri.

Q. Do earnings measures such as EPS necessarily reflect customer interests?

A. No. With the possibility of restructuring and deregulation and with increased merger activity within the electric utility industry over the last several years, utilities have sought to become leaner to survive. A market based utility industry will require that utilities generate profits without the benefits of a captive customer base. Employee reductions and other means to increase the bottom line have become the norm. UE, in its September 30, 2001, *Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934*, (Form 10-Q) issued to the United States Securities and Exchange Commission (SEC) discusses its operations:

> The Registrant, in the ordinary course of business, explores opportunities to reduce its costs in order to remain competitive in the marketplace. Areas where the Registrant focuses its review include, but are not limited to, labor costs and fuel supply costs. In the labor area, over the past two yeas, the Registrant has reached agreements with all of its major collective bargaining units which will permit the Registrant to manage its labor costs and practices effectively in the future. The Registrant also explores alternatives to effectively manage the size of its workforce. These alternatives include utilizing hiring freezes, outsourcing and offering employee separation packages. In the fuel supply area, the Registrant explores alternatives to effectively manage its overall fuel costs. These alternatives include diversifying fuel sources for use at the Registrant's fossil power plants, as well as restructuring or terminating existing contracts with suppliers.
>
> Certain of these cost reduction alternatives could result in additional investments being made at the Registrant's power plants in order to utilize different types of coal, or could require nonrecurring payments of employee separation benefits or nonrecurring payments to restructure or terminate an existing fuel contract with a supplier. Management is unable to predict which structure will be executed. Management is unable to determine the impact of these actions on the Registrant's future financial position, results of operations or liquidity.
> [Emphasis added.]

The motivation for increasing EPS is to enhance shareholder value. Safe and adequate service with just and reasonable rates are the standards that regulated utility companies are required to meet in Missouri. UE may argue that an increase to the bottom line creates a healthier utility which then automatically benefits customers. There is no direct cause and effect relationship between increased income and/or decreased expense and better customer service.

Q. Mr. Lindgren on page 9 lines 1-11 discusses weather normalization and why it is not appropriate for EPS in relationship to incentive compensation payouts. Does the Staff agree with Mr. Lindgren?

A. No. Weather conditions are obviously outside the control of a utility. The impact of weather is typically normalized during a rate case proceeding and should also be normalized in relationship to incentive compensation payouts that result from financial measurements. Weather will impact EPS and business line/function goals if tied to budget targets. During a June 4, 2002, interview with Mr. Lindgren, he stated that the 2001 EPS was adjusted for weather in relation to the incentive compensation payout levels. The Staff has submitted a data request to verify that this actually did occur and is awaiting a response.

Q. Mr. Cross on page 8, lines 5-7 of his rebuttal testimony identifies the incentive target as the market competitive level of incentive. Has the target level EPS been the incentive level to which incentives have been paid during the test year?

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Staff's Alternative Position

Q. Is there any incentive compensation plan that the Staff would include in a utility company's cost of service?

A. Yes. An incentive plan that does not rely on an earnings measurement such as EPS for the payout mechanism could meet the criteria for inclusion in a utility company's cost of service.

Q. If the Commission were to decide that EPS was an appropriate threshold funding mechanism for payment of incentive compensation, would the Staff have other reasons why it believes that the UE incentive compensation plans should not be included in cost of service?

A. Yes. The Staff would still propose a partial disallowance of the costs associated with the incentive compensation plans based upon its review of the plans. An evaluation of each plan for purposes of the Staff's alternative recommendation follows:

Evaluation of the AIP

Q. Would the Staff disallow the 2000 AIP incentive compensation plan costs?

A. Yes. The AIP for 2000 was based entirely upon EPS, a shareholder benefit measure. There were no Business Unit goals or Individual goals set, nothing to tie job performance to ratepayer benefits. All employees would still be paid incentive compensation under the AIP if the EPS threshold level was met. Even if employee performance beyond that required under an employee's basic job requirements was not achieved.

Evaluation of the AMIP

Q. Does the Staff have concerns about the criteria for incentive compensation awards related to the AMIP as well?

A. Yes. As with any incentive compensation plan, the Staff believes that employee goals must be required to improve job performance beyond basic job requirements. Goals must be quantifiable and a relationship to improved customer service or benefit should be ascertained.

Q. Do the Business Line/Function goals within the AMIP need to meet the same criteria as individual goals?

A. Yes. Goals should be set that demonstrate improved business unit performance over prior years. The goals should be quantifiable and customer benefits should be directly identifiable.

Q. Has the Staff reviewed the business and individual goals of the AMIP for 2000?

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The amount of data that the Staff has received to date does not provide the level of detail to draw conclusions about the level of impact employee performance has on the goal results. The impact of technology and other external forces on goal results also skews the results. However, the four quadrants used to set business line/function goals do provide a distinction between goals directed towards shareholders, the Company and ratepayer benefits. While financial and process efficiency/innovation goals can be typically quantified in dollars, employee and customer goals may not be. The Staff would suggest that if all stakeholders benefit from the AMIP when employees attain goals, then all stakeholders should contribute to the cost of the AMIP.

Q. On page 2 of Mr. Cross's testimony he states that the primary objectives of an incentive plan are to attract, retain and motivate employees. Does the Staff find that UE has an employee retention problem?

A. No. In response to Staff Data Request No. 154, UE provided employee turnover levels for the years 1997 through 2001. Excluding retirements, the total number of employees that have chosen on a voluntary basis to leave the Company between 1997 and 2001 is sixteen out of an average of over 4,000 employees. UE does not have a retention problem.

Q. Has the Staff reviewed the individual goals of the AMIP for 2000?

A. The Staff has not completed its analysis. A request to review a sample of 2000 and 2001 employee evaluations associated with the AMIP payouts was made on June 4. The Staff will determine an allowable level of incentive compensation for the AMIP employees for its "alternative" position on incentive compensation based upon its analysis.

Q. Do you plan to file supplemental surrebuttal to address your evaluation of the AMIP incentive plan based upon the response to Staff data requests still outstanding?

A. Yes. I plan to file supplemental surrebuttal testimony if the responses to the outstanding data requests are received. A summary of the Business Line/Function goals for 2000 and the corresponding payout percentages resulting from performance are included in Schedule 2 attached to my testimony, and may be updated to include additional information. In addition, information related to individual goals for AMIP employees and the payouts for the EIP employees may be included in supplemental surrebuttal if the information is provided.

Evaluation of the EIP

Q. Has the Staff requested a sample of employees from the ALT to assess the goals set for the EIP employees for 2000 and 2001?

A. Yes. Upon review of this information, the Staff will determine if any incentive compensation awards distributed to the EIP employees should be included in UE's revenue requirement under the "alternative" position.

Q. Does the Staff, based upon information already received in data request responses believe that it is likely that the EIP payouts will meet the Commission's criteria for allowing incentive compensation in rates?

A. No. From all information received to date, it appears that the EIP payouts are not tied to specific pre-set standards or goals that can be provided in writing or quantified, although Ameren's annual 2000, *Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934*, (DEF 14A) to the SEC filed on March 15, 2001 includes the following:

> The second component of the executive compensation program is a performance-based Executive Incentive compensation Plan established by the Ameren Corporation Board, which provides specific, direct relationships between corporate results and Plan compensation. For 2000, Ameren consolidated year-end earnings per share (EPS) target levels were set by the Human Resources Committee. If EPS reaches at least the minimum target level, the Committee authorizes incentive payments within prescribed ranges

> based on individual performance and degree of responsibility. If EPS fails to reach the minimum target level, no payments are made. Under the Plan, it is expected that payments to the Chief Executive Officers of Ameren Corporation and its subsidiaries will range from 0-37% of base salary. <u>For 2000, actual payments ranged from 28.8% to 35.6% of base salary.</u>
> [Emphasis added.]

The Staff is not sure why UE has failed to provide details related to the EIP goals for 2000. The Staff's analysis would be similar to what was performed at Empire District Electric Company for its Management Incentive Plan (MIP). Easily attained EIP goals that are not beneficial to the general body of ratepayers, and awards which may be exorbitant, even if the goals are appropriate, should not become moving targets used merely to enhance EIP employee salaries. The Ameren 2001 DEF 14A report to the SEC states that incentive compensation payments to Chief Elected Officers could range from zero to ninety percent of base salary. The 2001 EPS fell below the target level, therefore actual EIP payouts were held to 27.9 % to 39.6 % of base salary.

The job requirements of executives often require that they devote time and energy to multiple subsidiaries of the parent company. There is no reason to believe that this is not the case at Ameren. Increased non-regulated activity and an emphasis on shareholder value may require increasing amounts of executive time. It is highly unlikely that Missouri ratepayer benefits are included in individual goals when the emphasis of the Company is on earnings and the growth of non-regulated subsidiaries.

Q. Mr. Lindgren, on page 10 lines 18-19 of his rebuttal testimony, states the most significant influence on the payment of incentives is the employee's individual and functional performance, which directly focuses on the interests of Missouri ratepayers. Does the Staff agree with Mr. Lindgren?

A. No. The Staff believes that the most significant influence on the payment of incentives is the level of EPS. An employee could meet all individual goals and contribute to a Business Line/Function that attains one hundred percent of its goals including exceptional service to Missouri ratepayers and still be denied an incentive compensation payout or be penalized by an EPS level falling below the threshold or target. The Staff has not been able to ascertain from information provided in response to Staff data requests that Mr. Lindgren's statement is accurate for employees participating in the EIP. When outstanding data request responses related to EIP are received an analysis will determine if indeed the interests of Missouri ratepayers are included in the employees' individual and functional performance. Key performance indicators that correspond to improving shareholder value as opposed to enhancing Missouri ratepayer benefits would be disallowed and the incentive compensation payouts reduced proportionately.

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Q. What amount of incentive compensation expense has the Staff proposed to disallow in its direct filing for this case?

A. The Staff has disallowed all of the incentive compensation awards for the year 2000 that were paid during the test year.

Q. Why has the Staff disallowed all of the incentive compensation expenses from UE's cost of service?

A. The Staff opposes the inclusion of UE's incentive compensation expense for several reasons:

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The criteria that the Staff uses to determine if incentive compensation awards should be included in a utility company's cost of service are based upon past Commission Reports and Orders that address specifically the issue of incentive compensation. In addition, the Staff's criteria for inclusion of any expense in cost of service is contingent upon the costs being known and measurable and representative of ongoing expenses. I have addressed each of these reasons for opposition to the inclusion of incentive compensation plan costs in cost of service in my surrebuttal testimony.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

SUMMARY OF RATE CASE TESTIMONY FILED

Janis E. Fischer

COMPANY	CASE NO.
Empire District Electric Company	ER-97-81
Union Electric Company (AmerenUE)	GR-97-393
Osage Water Company	WA-98-236/ WC-98-211
Western Resources/Kansas City Power & Light Company	EM-97-515
UtiliCorp United, Inc./St. Joseph Light & Power Company	EM-2000-292
UtiliCorp United, Inc./Empire District Electric Company	EM-2000-369
KLM Telephone Company	TT-2001-120
Empire District Electric Company	ER-2001-299
Missouri Gas Energy, Division of Southern Union Company	GR-2002-292
Missouri Public Service, Division of UtiliCorp United, Inc.	ER-2001-672/ EC-2002-265
Missouri American Water Company, Division of American Water Works Company, Inc.	WO-2002-273
Citizens Electric Company	ER-2002-217
Laclede Gas Company	GR-2002-356

FISCHER

SCHEDULE 2

DEEMED

PROPRIETARY

IN ITS ENTIRETY