

## COMPENSATION, WAGES, BENEFITS

### 1.0 OVERVIEW

Hydro One has experienced rapidly increasing transmission and distribution work programs since 2004. Resourcing of these work programs must occur on the most cost-effective basis possible within a highly competitive labour market.

Table 1 below outlines the compensation costs for Hydro One Networks employees from 2004 to 2008. The Company believes that the upward trend in these costs is reasonable in light of the steadily increasing transmission and distribution work programs since 2004, as well as the negotiated increases in labour rates.

The actual breakdown of compensation by employee category follows in Exhibit C2, Tab 3, Schedule 1.

Hydro One Networks Inc. Payroll* (M\$)					
Year	Total Wages	Base	Overtime	Incentive	Other**
2004	404.2	323.7	53.2	12.3	15.0
2005	397.9	321.1	50.6	8.4	17.7
2006	459.3	368.0	66.5	4.4	20.5
2007	495.5	414.7	60.9	6.6	13.2
2008	580.7	475.5	72.1	8.5	24.6

\* This payroll reflects compensation costs associated with year-end headcounts for all EPSCA, PWU, Society and MCP staff.

\*\* "Other" includes travel time, vacation bonus, unused vacation days paid out, standby allowance, shift allowance, vacation pay on termination.

### 2.0 COMPENSATION STRATEGY

Operating within an increasingly competitive labour market, Hydro One has faced, and continues to face, a number of challenges with respect to establishing and maintaining a more favourable cost structure. Most notably, more than 90% of the workforce is

1 unionized, and came to Hydro One with pre-existing collective agreements. The  
2 collective agreements are complex and comprehensive and incorporate by reference the  
3 pension and benefit plans. Because 70% of the workforce is represented by a single  
4 union, the Power Workers' Union ("PWU"), the Corporation would be unable to continue  
5 operations for a sustained period in the event of a work stoppage by that union.  
6 Consequently, the primary focus in collective bargaining with the PWU has been on  
7 increasing productivity and on increasing management flexibility to run the operations  
8 rather than on seeking compensation concessions.

9  
10 With respect to the Society, the corporation has substantially altered pension entitlements  
11 for new hires and recently negotiated a five year agreement which will provide labour  
12 stability and cost predictability. Highlights are provided in section 3.2 of this exhibit.

13  
14 In terms of Management compensation, Hydro One has endeavoured to strike a balance  
15 between the need to attract and retain competent staff and the need to constrain costs. To  
16 this end it has increased hours of work for all Management staff and substantially altered  
17 pension and benefit provisions for new hires.

18  
19 Hydro One has undertaken an independent benchmarking study on labour rates and  
20 overtime in response to the Board's directive EB-2005-0378. Hydro One issued a  
21 Request for Proposal for this study and ultimately engaged Hay Management  
22 Consultants. The study will benchmark sample Management, PWU and Society  
23 positions.

### 24 25 **3.0 LABOUR AGREEMENTS**

26  
27 Hydro One has direct collective agreements with the Power Workers Union (PWU), the  
28 Society of Energy Professionals, the Canadian Union of Skilled Workers (CUSW) and  
29 the Labourers' International Union of North America (LIUNA) as well as collective

1 agreements with each of the 15 Building Trade Unions (BTU's) through membership in  
2 the Electrical Power Systems Construction Association (EPSCA). The key agreements  
3 are with the PWU and the Society.

4  
5 PWU – This industrial collective agreement covers wages, pensions, benefits and  
6 working conditions. The contract has been reduced in size and complexity since it was  
7 inherited from Ontario Hydro in 1999, in order to provide Management with the  
8 flexibility to direct and effectively utilize the workforce. However, wage rates, pension  
9 entitlements, and benefit coverage are prescribed and can be changed only through  
10 negotiations.

11  
12 Society – This collective agreement covers wages, pensions, benefits and working  
13 conditions for professional staff. The Society had mandatory mediation/arbitration since  
14 the formation of Hydro One until 2005. Through arbitrated awards, Management  
15 attained some increases in flexibility and cost reduction in return for market rate wage  
16 increases. In 2005, mediation/arbitration did not apply and traditional bargaining took  
17 place. The resultant settlement, although obtained via arbitration was more responsive to  
18 Management's needs in that it established a two tier pension plan for new Society  
19 employees. As noted earlier, a renewal collective agreement was negotiated during the  
20 second quarter of 2007 and ratified on June 29, 2007.

21  
22 **3.1 PWU**

23  
24 Compensation of PWU-represented employees is negotiated through the collective  
25 bargaining process. An aging workforce in technical and trades positions in the utility  
26 industry is likely to limit the supply of skilled staff in the future, putting upward pressure  
27 on wages.

1 The key focus with respect to the PWU has been to achieve increased management  
2 flexibility to run the operations, as opposed to wide scale reductions in wages, benefits  
3 and pensions.

4

5 The gains made to date with respect to PWU negotiations include:

- 6 • PWU Incentive Plan non-renewal
- 7 • Lower meter reader B rate negotiated
- 8 • Modified duty hours
- 9 • Switching agents for stations
- 10 • Winter meal reduction
- 11 • Temporary headquarters established

12

13 The bulk of the gains were the result of 2005 contract negotiations with the PWU and  
14 total about \$12 million between 2004 and 2008. Hydro One will be entering into new  
15 negotiations with the PWU in January 2008 in advance of expiry of the current contract  
16 on March 31, 2008.

17

18 It is likely an attempt by Hydro One to achieve significant cost reductions in wages,  
19 benefits and pension would result in a strike. The last PWU strike was in 1985 and lasted  
20 12 days. It was handled by placing management and Society-represented staff in key  
21 functions to maintain operations/service to the extent possible. However, as a result of  
22 numerous downsizing programs, and re-organization of work, there are far fewer  
23 management staff available today with the requisite skills and experience to occupy key  
24 PWU positions during a strike. As a result, the Company would be unable to continue  
25 operations during a prolonged PWU strike.

26

1 **3.2 Society**

2  
3 Compensation of Society-represented employees is negotiated through the collective  
4 bargaining process. Hydro One's goal is to compensate Society-represented staff at  
5 levels competitive in the market place in order to maintain the ability to attract, motivate  
6 and retain competent staff. For the utility industry, an aging workforce within operations  
7 management and specialist engineering positions is likely to limit the supply of skilled  
8 employees in the coming years, putting upward pressure on compensation. Further,  
9 utility hiring practices from the mid-1980's until recently have resulted in fewer  
10 engineers with requisite education and experience being available in the workforce.

11  
12 In establishing rates for Society-represented staff, Hydro One considers the average  
13 industrial wage settlements, Consumer Price Index, and survey results from the Ontario  
14 Society of Professional Engineers. This survey is used as a major data source since  
15 engineers are the single biggest classification within the Society. As an employer, Hydro  
16 One focuses on the marketplace more than on inflation. Hydro One's goal is to occupy a  
17 certain position in that marketplace in order to attract, motivate and retain the kind of  
18 talent required.

19  
20 With respect to the Society, the strategy prior to 2005 had been to achieve increased  
21 management flexibility to run the operations. Until then, the Society had mandatory  
22 mediation/arbitration as the method of dispute resolution, so there had been no strikes.  
23 Following the elimination of this approach in 2005, the Society conducted a 15-week  
24 strike. Subsequent arbitration resulted in a salary increase of 3% on April 1, 2005, and  
25 on April 1, 2006 and April 1, 2007. The expiration of that agreement was originally  
26 scheduled to occur on March 31, 2008. However, on April 5, 2007 both parties  
27 announced an early start to negotiations, having successfully concluded several months of  
28 co-operative work to resolve a variety of issues and disputes remaining between the  
29 parties. A new agreement was ratified on June 29, 2007 and, the Ontario Labour

1 Relations Board has granted permission to make the new collective agreement July 1,  
2 2007.

3  
4 Highlights of the agreement are below:

- 5
- 6 • The term is for five years, from April 1, 2008 to March 31, 2013. This has  
7 administrative savings since there is no need for bargaining for the next 5 years. It  
8 also ensures stability and predictability around a portion of the labour costs.
  - 9 • Salaries will rise by 3% on April 1 2008, 2009 and 2010, and by 2.5% on April 1,  
10 2011 and 2012, with cost of living adjustments provided in the last three years.
  - 11 • Effective October 1, 2007, a new automatic step progression plan will replace the  
12 current performance pay plan (which had a mandatory 1% of base payroll payout per  
13 year).
  - 14 • The salary range for all bands will be equivalent to 70-100% of current bands, with  
15 established progression steps. (replacing the existing 80-115% ranges).
  - 16 • Unfair labour practice complaint and over 100 related grievances are resolved or  
17 withdrawn.
  - 18 • Effective April 1, 2008, Hydro One will no longer subsidize the cost of optional life  
19 insurance.
  - 20 • Hydro One will no longer add new spouses and children of re-married pensioners,  
21 surviving spouses of pensioners and surviving spouses of employees to the Health  
22 and Dental Plan.
  - 23 • As a result of the change to the Society Purchased Services Agreement, Hydro One  
24 has no parameters or processes that restrict or inhibit its ability to contract out, other  
25 than the company can not lay off a Society represented employee as a direct result of  
26 contracting out his/her work.

27  
28 In addition to the gains achieved during the recent round of negotiations, earlier notable  
29 gains have included:

- 1 • Cancellation of the annual incentive plan that had a maximum payment of 4% of base  
2 salary with a potential savings of \$2.7M per year.
- 3 • Implementation of a two-tier pension plan for Society-represented employees hired  
4 after November 16, 2005 which is approximately 25% less costly than the existing  
5 plan for Society-represented staff hired prior to that date.
- 6 • Elimination of mandatory mediation/arbitration.

7  
8 Hydro One believes these gains are consistent with the direction provided by the Board to  
9 continue its efforts to manage its overall compensation costs.

### 10 11 **3.3 Management Compensation Plan (“MCP”)**

12  
13 Following the Ontario Hydro demerger, Hydro One introduced a new Management  
14 Compensation Plan (MCP), which included base salary, benefits and variable pay. The  
15 MCP is designed around a structure comprised of 10 broad band levels.

16  
17 The advantage of such a system is that it reduces the number of pay layers, simplifies  
18 administration, and provides increased opportunity for employees to progress as they gain  
19 skills and experience, without the frequent need to change positions. This plan is built  
20 around compensation goals and principles reflecting the need:

- 21  
22 • To attract and retain competent executives.
- 23 • To achieve ongoing performance improvement.
- 24 • To align the interests of management and shareholder.
- 25 • To link compensation to the achievement of corporate objectives and individual  
26 performance.
- 27 • To provide flexible salary ranges, enabling executives to move up the ranges based on  
28 annual performance.

- 1 • To provide incentive pay on an annual basis and based on a rigorous performance  
2 management system.

3  
4 Each management position is assigned to a salary band according to the accountabilities,  
5 size and complexity of the job. An employee's base salary within the pay band depends  
6 upon their expertise relative to the requirements of the job and is reviewed annually.  
7 Hydro One establishes reference positions using the Hay Methodology. All Hydro One  
8 MCP jobs are rated against these reference positions for scope and complexity.

9  
10 Base salary adjustments for MCP staff are tightly managed and have never been applied  
11 as "across-the-board" economic increases, but rather to reflect improved competency in a  
12 job. In 2004, 2005 and 2006, 2.5%, 3% and 4% respectively were made available as base  
13 salary increases, by the Human Resource and Public Policy Committee of the Company's  
14 Board of Directors.

15  
16 The variable pay concept is another key component of the management compensation  
17 strategy. Each of the 10 broad base salary bands has a maximum variable pay range  
18 associated with it. These maximums are percentages of the individual's base salary, and  
19 have been determined through an assessment of compensation practices in the target  
20 market. As noted earlier, two of the Hydro One management compensation principles  
21 are:

- 22  
23 • Linking compensation to the achievement of corporate goals and individual  
24 performance.  
25 • Providing incentive pay on an annual basis and based on a rigorous performance  
26 management system.

27  
28 Hydro One believes that its short-term incentive program meets both of these principles  
29 in a cost-effective manner. The program provides an incentive payment, based on an

1 employee's performance against a specific set of annual performance criteria and factors  
2 in corporate performance. The incentive is re-earnable every year, so it is not built into  
3 the employee's ongoing compensation. In years where performance is not strong, a  
4 reduced incentive, or no incentive pay, will be provided. Even in a year in which Net  
5 Income is achieved but other performance measures are not, there may not be an  
6 incentive payout. The re-earnable aspect of the program reflects a best practice approach  
7 since it minimizes the long-term compensation costs and allocates pay based solely on  
8 performance. Furthermore, the link between the performance factors and the Company's  
9 strategic goals (described in Exhibit A, Tab 3, Schedule 1) ensures that management  
10 performance is driven by a balance of considerations – the need for a safe workplace,  
11 customer focus, reliability, financial performance and employee and shareholder  
12 relations. These together, help create a high-performance, more efficient work  
13 environment. Achievement of these goals directly benefits the ratepayer and therefore it  
14 is appropriate that any incentive paid related to achievement of these goals, including net  
15 income, should be included in the revenue requirement.

16  
17 Hydro One utilizes Hay Consulting to evaluate its positions relative to the market.  
18 Compensation adjustments are made as deemed necessary to attract, motivate and retain  
19 competent staff.

20  
21 In May, 2007, the Agency Review Panel (the "Arnett Panel") submitted its report on  
22 Phase I of its review of Ontario's provincially-owned electricity agencies. The Arnett  
23 Panel has provided the Government with a report on executive compensation. The  
24 Government supports the report and has indicated it will provide a directive to the Hydro  
25 One Board of Directors with respect to implementing the report's recommendations.

26  
27 Currently, the compensation strategy for MCP is that Hydro One targets total cash  
28 compensation at the 75<sup>th</sup> percentile of the target market comparator group, which is the  
29 Hay All Industrial Component. The organizations in this study represent corporations

1 which are in the electricity sector or related fields and with which Hydro One competes  
2 for talent.

3  
4 Hydro One's best performers are highly marketable, and several key management staff  
5 have left the company in recent years. The Hydro One succession plan has facilitated  
6 internal promotion and a smooth transition in most cases, but our internal replacement  
7 capacity is now significantly diminished in key areas. External recruitment has proved  
8 challenging as our compensation levels and structures have fallen below the market for  
9 top people. The Human Resources and Public Policy Committee mandate requires a  
10 review of the Management Compensation Structure every year. Hay Management is  
11 utilized to assist in the review. Recommendations are ultimately presented to the Board of  
12 Directors for approval. (Following a 2006 review, Hay recommended that the minimum  
13 and maximums of the majority of bands be increased in order to maintain market  
14 relativity)

15  
16 In terms of Management compensation, Hydro One has endeavoured to strike a balance  
17 between the need to attract and retain competent staff and the need to constrain costs. To  
18 this end it has increased hours of work for all Management staff and substantially altered  
19 pension and benefit provisions for new hires.

#### 20 21 **4.0 PENSION AND BENEFITS**

22  
23 Hydro One Networks is a participant in the Hydro One Pension Plan ("Plan"). The Plan is  
24 a contributory, defined benefit pension plan whose members comprise represented  
25 employees of the Power Workers Union ("PWU"), Society of Professional Engineers  
26 ("Society"), non represented management employees, employee pensioners and  
27 beneficiary pensioners.

1 In an effort to contain escalating benefit and pension costs, in January 2004 the  
2 Corporation introduced revised pension and benefits plans for MCP hired after January 1,  
3 2004. These new plans are approximately 25% less costly than the previous plans. As  
4 noted previously, the revised pension plan is also applicable to Society staff hired after  
5 November 16, 2005. Additional detail on pension costs is contained in Appendix A of  
6 this Schedule.

7

## 8 **5.0 SUMMARY**

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10 As noted previously, in a heavily unionized environment, there are significant constraints  
11 on an employer's ability to reduce compensation costs per employee. However, despite  
12 these constraints, the Corporation has made significant gains in the reduction of pension  
13 and benefits costs for MCP staff and pension costs for Society-represented staff. The  
14 elimination of the incentive plans for PWU and Society has reduced potential cash  
15 payouts to the PWU and Society by 6% and 4% respectively. Hydro One will also  
16 continue its focus on increasing productivity and management flexibility to run the  
17 business.

18