

**THE REPORT OF THE AGENCY REVIEW PANEL**

**ON PHASE I OF ITS REVIEW OF**

**ONTARIO'S PROVINCIALY-OWNED ELECTRICITY AGENCIES**

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**May 2007**

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### **Appendix**

Deloitte Findings Report, April 30, 2007

## 1. Introduction

The Agency Review Panel was established on January 29, 2007 to review specific issues concerning five named Provincial electricity sector institutions, namely: Hydro One Inc. (Hydro One), the Independent Electricity System Operator (IESO), the Ontario Power Authority (OPA), Ontario Power Generation Inc. (OPG) and the Ontario Energy Board (OEB), which are in “public hands” (collectively, the “Institutions”).

The Panel was instructed to conduct its work in two phases. This report is the Panel’s report on Phase I dealing, broadly speaking, with executive compensation at the Institutions. Our review for Phase II will require a more in-depth examination of the roles and function of the Institutions.

Specifically, in Phase I we were asked to:

- (a) Undertake a review with respect to methodologies for determining the overall compensation to be paid to the senior management group and executives employed in provincial electricity sector institutions including salary, benefits, performance payments, severance, and any other aspect relating to compensation benefits. As part of this work, the Panel was to consider the levels of compensation paid within comparable public sector organizations and in agencies and institutions in other jurisdictions.
- (b) Provide advice and recommendations with respect to the overall levels of compensation arrangements for the senior management group and executives employed in provincial electricity sector institutions to take effect upon the replacement, at the time of the retirement, resignation, or otherwise, of the current incumbents or upon negotiation of new contracts to be entered into at the time of the expiry or renegotiation of the contracts of the current incumbents.

Accordingly, the Panel has reviewed the existing arrangements, not as a forensic review but rather as a base for making recommendations for the future. In the course of this, we have sometimes made generalized findings which will not necessarily apply to each Institution.

In being asked to provide advice and recommendations with respect to future compensation arrangements, the Panel understands that it is not being asked to recommend specific compensation numbers. Furthermore, the Panel believes that this would be unwise and inappropriate. That is the job of the independent corporate boards, and their committees, in the exercise of good governance.

## 2. **Process**

The Panel relied principally upon the following sources of information:

- (a) We asked for and received written submissions from the Institutions. We reviewed and discussed these submissions in meetings among the Panel members and the board chairs and compensation committee chairs of the respective Institutions.
- (b) Deloitte Inc. was retained to review such submissions as well as external market “best practices” for executive compensation. Among other things, they provided information on compensation at comparable public and private sector organizations both in and outside of Ontario. The Deloitte report is attached as an Appendix.
- (c) Panel members, assisted by staff seconded to the Panel from the Ontario government, reviewed other publicly available information as seemed appropriate and reasonable. In particular, we reviewed a recent Green Paper Report prepared by Murray Bryant and Stephen Sapp of the Richard Ivey School of Business for the Institute of Corporate Directors Blue Ribbon Commission on the Governance of Executive Compensation in Canada (Bryant Report). The Bryant Report only deals with the private sector but was very helpful to the Panel.

- (d) The Panel solicited the views of the Leader of the Opposition and of the Leader of the New Democratic Party.

### 3. **Brief History**

Executive compensation in Ontario's public sector has been an issue of public concern for more than a decade.

Prior to 1996, when the Ontario government passed the *Public Sector Salary Disclosure Act*, public attention and media coverage centred on the fact that public sector salaries and other forms of compensation were undisclosed, i.e., secret. The purpose of the Act was to make government more open and accountable, allowing taxpayers to compare the performance of an organization with the compensation given to the people running it, and to be better informed of how public dollars are spent.

Since 1996, public attention and the media spotlight seems to have shifted to a concern that executive compensation in the public sector is, in some cases, too high. This attention reaches a peak each spring when public sector employers are required to state, by name and position, those employees receiving compensation of \$100,000 or more a year.

In recent years, this attention has focused in particular on executive compensation in Ontario's publicly-owned electricity sector. Among the reasons for this are the following:

- The electricity sector is of critical importance to the citizens of Ontario, both because electricity use is essential to their daily lives and because it is essential to the functioning of a modern economy, i.e., jobs.
- Since almost the entire sector, including the Institutions, is owned by the public, comprising an aggregate investment of approximately \$25 billion, the general public, as taxpayers and ratepayers, have a proprietary interest.
- Senior executives of Hydro One and OPG receive the highest compensation in Ontario's public sector by a very wide margin.

- The sector itself has been in some turmoil for a decade. This is not the place, nor is there any need, to recite the details but we note the following consequences of this turmoil:
  - (i) high turnover in senior executive ranks, which tends to push up compensation levels, and
  - (ii) the potential privatization of Hydro One, which highlighted its compensation levels.

Executive compensation is a major and contentious issue in the private sector as well. The business news focuses on it constantly; for instance, the April, 2007 issue of “Financial Post Business” refers to “outrage over CEO pay that is utterly disconnected from performance”, leading to calls for “reform”. As we shall see, private sector norms affect the public sector, too.

#### 4. **Governance of the Sector**

Compensation is a governance issue.

“Sunlight”, that is, transparency, is essential to competent, honest and trusted governance in a democratic society and a market economy.

So is accountability: once the public knows the facts, if there are issues someone must be held accountable.

The basic questions are:

- Who decides on compensation arrangements?
- How is the decision made?
- What are the appropriate considerations in deciding upon reasonable levels of compensation?
- How are the answers to these questions disclosed?
- Who is held accountable, and how?

The electricity sector in the Province of Ontario is owned principally by the public through the Provincial government's ownership of the Institutions. OPG generates 75% of the electricity produced in the Province; Hydro One transmits most of the generated electricity to local distributors and handles some of the local distribution; IESO runs the market and ensures reliability, OPA does long term planning and conservation for the sector; and OEB regulates many of these operations through public hearings.

The remaining 25% of the electricity generated is produced by privately-owned enterprises and sold through IESO.

While there are technical differences in the forms of incorporation of the Institutions, for our purposes they can all be viewed as "Crown corporations", that is, distinct corporations wholly owned by the Government of Ontario.

Profound issues of governance flow from the fact that the Province has chosen to hold its interests in the sector through Crown corporations. The Panel quotes from a recent publication of the Canadian Institute of Chartered Accountants (CICA):

"Crown corporations are distinct legal entities that are wholly owned or controlled by government. In serving the public interest, they are expected to operate in a **commercial manner** and are provided with a higher degree of autonomy than the rest of government. They manage billions of dollars of assets and liabilities and operate in many sectors of the Canadian economy, including ... energy ...

As in the private sector, **boards of directors of Crown corporations play an important governance role**. The board approves the strategic direction for the corporation, ensures that the principal risks of the corporation's business have been identified and that appropriate systems to manage those risks have been implemented; approves annual operating business plans, capital plans and budgets; oversees management; **hires the CEO** (with

some exceptions in some jurisdictions); **evaluates and determines the CEO's compensation**; ensures management succession planning; ensures the corporation has appropriate information systems and management practices; ensures the corporation complies with financial and other requirements; and ensures accurate reporting of the corporation's finances and operations to the shareholder and the public. Good governance practices relating to accountability, fair dealing and ethics are just as important in Crown corporations as they are for the private sector.

To be effective, **boards of directors of Crown corporations should adopt those corporate governance "best practices" that have developed over the last decade – such as** clearly defined roles and responsibilities, efficient use of committees, clear codes of ethical conduct, informed approaches to policy and strategic planning, risk management, financial oversight, **responsible management compensation**; board composition and succession planning, director orientation, ongoing professional development, and board and director assessment.

**However, Crown corporations operate within a unique environment.** Their shareholder is government which, in and of itself, is a multi-faceted entity that does not always speak consistently. **They operate within a political context. There are public policy issues that must be taken into consideration in decision-making.** They are subject to public sector legislative and policy requirements. They generally have significant implications for effective corporate governance.”<sup>1</sup> (Emphasis added)

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<sup>1</sup> “20 Questions Directors Should Ask About Crown Corporation Governance”; The Canadian Institute of Chartered Accountants, 2007.

The Crown corporations themselves are organized with boards of directors, with oversight responsibility, and chief executive officers (CEOs) and other senior management to whom the daily management has been further delegated.

The Panel has the following observations on these broad governance issues:

- (a) As Crown corporations, OPG, Hydro One, IESO and OPA have a mix of “commercial” and “public policy” objectives. As is usually the case, balancing that mix is difficult and delicate.

The 2004 Manley Report on OPG expressed it this way:

"The starting point is that the government must mandate the leadership of OPG to build a competent, commercially-oriented company, free of political interference and subject to clear public oversight."

So, both the CICA and Manley agree a Crown corporation must operate commercially. But the CICA notes they operate within a political context whereas Manley says they should be free of political interference. What does this mean? We think it means they should be free of day-to-day, operational interference by Government but they have to remember they are serving the interests of the general public, which has different expectations than private investors.

- (b) The determination of broad strategic objectives for the electricity sector is made by the Province through legislation, regulations and other directives.
- (c) The corporate boards have been mandated to achieve those objectives.
- (d) For the system to work, the boards have to do their jobs and be held accountable. They must adopt, and actually follow, corporate governance best practices. They also have to handle the commercial/public policy balancing act.

- (e) Corporate boards need to attract and maintain appropriate management, and other employees, and to do that, they have to decide on compensation.
- (f) Executive compensation is a key governance mechanism facilitating the alignment of executive interests with those of the shareholder (Bryant Report).  
As the Manley Report said:  
  
“Accountability and compensation are closely linked.”
- (g) Compensation is a very complex issue and there is no one-size-fits-all method, and a combination of art and science must be used in each specific case. Therefore, it should be left to the compensation committees of particular corporations to decide in specific cases. (Bryant Report)

## 5. Findings on Governance

The Panel makes the following findings on governance:

- (a) OEB is separate and distinct from the other Institutions. Historically the OEB regulated only the natural gas market but several years ago, as part of the opening of the electricity market, the OEB’s mandate was extended to regulation of the electricity market and it was turned into a self-financing Crown corporation. As part of this change and extension of its role, specific compensation arrangements were agreed with the Province. The reconstruction of the OEB having been substantially and successfully completed, the fact remains that it is a regulatory agency. It operates much in the same way as other provincial regulatory agencies such as the Ontario Municipal Board or the Ontario Securities Commission. It does not manage large assets and liabilities, incur risk or otherwise operate in a commercial manner. It is organized very differently and does not have an independent board of directors. Compensation is fixed by its management committee and approved by the Minister of Energy (at or below the recommendation of an independent third party consultant). Accordingly, it is not subject to our general recommendations, but is the subject of a specific recommendation.

(b) A healthy corporate governance culture is developing in the boards of directors of these Crown corporations. In particular, we note the following:

- Independent Directors. The Members of the boards of directors are appointed by, but independent of, the government. Indeed, we congratulate the Government on attracting a number of highly qualified independent directors, and we commend those directors for the valuable service they provide.
- Independent Compensation Committees. They have compensation committees comprised of independent directors.
- Board/Committee Process. We believe these boards and committees have adopted processes which would appear to accord with most current standards of good governance.
- Self-Assessment. These boards do follow current private sector “best practices” for self-assessment. The Panel notes that the self-assessment model has come to be recognized as a very valuable tool in improving the performance of boards, committees and individual directors.

## 6. **Specific Compensation Issues**

As stated, executive and senior management compensation is a very complex issue. There are several elements which may be included in the total compensation of any particular executive or manager:

- Base salary – fixed annual pay, which may be positioned within a range
- Short-term incentive pay (STIP) – often called a "bonus", is typically linked to performance management and provides a cash bonus for achieving or exceeding performance thresholds
- Long-term incentive pay (LTIP) – an award that is delivered beyond a one-year period through a variety of ways, including stock options

- Perquisites (Perks) – these are cash, programmes or services that are not specifically required to perform job duties, e.g. cars for people who do not need them for their jobs or social and business club memberships
- Pensions and other benefits – benefits might include health care benefits, while pensions can be provided in a number of ways, including supplementary employment retirement plans (SERPS). SERPS are often very significant in size and are typically funded out of general revenues, unlike normal pension plans..

Understanding issues of compensation is further complicated by reference to:

- Total Cash Compensation – the combined annual value of base salary and STIP.
- Total Direct Compensation – the combination of Total Cash Compensation plus LTIP.

However, while focusing on all of the above can be important, the ultimate compensation measure is Total Compensation, that is, Total Direct Compensation plus Perks, benefits and pensions.

The following is an example of how these elements would work:

Base Salary	\$300,000	
STIP (40% of Base)	<u>\$120,000</u>	
	\$420,000	
Total Cash Compensation		\$420,000
LTIP	\$ 36,000	
Total Direct Compensation		\$456,000
Pension, Benefits, Perks (30% of Base)	\$90,000	
Total Compensation		<u>\$546,000</u>

The two key elements which compensation committees and boards usually look at, in accordance with best practices, in determining compensation levels are the following:

- (a) Comparators - Determining the appropriate "comparator market". Compensation committees and boards try to figure out what they will have to pay to attract good people from the pool of people with the appropriate skills and talent. They do this by identifying those employers from whom they would like to recruit people or to whom they are most likely to lose good people. The committees and boards usually use the services of a third party consultant to assist them. These consultants compile surveys showing what comparable, or peer, companies pay their employees. The big question always is: what companies are you really competing with for talent? Are you just competing in your industry or outside as well? Are you only competing with companies of similar size or in your geographic area, or not? Furthermore, this may vary depending on job roles and specific responsibilities. OPG, for example, emphasizes the unique challenges in recruiting senior nuclear executives.
- (b) Positioning – Determining the appropriate "target percentile", that is, what position within the comparator marketplace is an appropriate reference point for determining the scope of an organization's compensation program. For example, a target 75<sup>th</sup> percentile places one in the (most expensive) top quartile while a 25<sup>th</sup> percentile represents the bottom (least expensive) quartile. In this, they are deciding how aggressive, or generous, to be when seeking to hire or retain people from the talent pool.

While much confusion may surround discussion about comparators and positioning, the basic point to remember is this: a lot flows from the decision about the appropriate comparator group.

Pension data is notoriously difficult to understand and compare. This is because the "value", or cost, of a pension is a current estimate (made by an actuary) of many variable factors pertaining to each pension. Yet it is a very significant part of Total Compensation. This is especially so for senior executives whose pensions can be greatly increased by such devices as:

- SERPs
- giving extra years of “credited service”,
- adding bonuses to base salary in calculating pensionable earnings, and
- providing full cost of living indexing.

A related issue is “termination payments” or “severance payments”, which is compensation paid to an employee dismissed without “just cause”. Such compensation will be paid at common law based upon what is reasonable notice to the employee in a specific case, but is often agreed in advance in executive employment agreements. “Just cause” is very serious misconduct, e.g., theft, sexual harassment or gross insubordination. Therefore, it is rarely found and such compensation is usually paid.

Even with independent boards, independent compensation committees and third party consultants, executive compensation in the private sector is problematic. Various explanations are given by various observers:

- the 3<sup>rd</sup> party consultants are sometimes not independent of management, who manipulate them to produce high comparator numbers
- directors and committees sometimes do not understand the complexities they are dealing with
- disclosure by competing companies sometimes has the perverse result of causing a "pay race" as each company tries to show it has the best (most expensive) CEO

Whatever may be the right explanation, securities regulators and organizations like The Canadian Coalition for Good Governance are still focusing primarily on disclosure, and on the structure and form of the compensation systems in place, to reign in excessive compensation. The disclosure regimes prescribe the specific information to be disclosed to the investing public. This reflects a continuing belief in the importance of transparency and accountability which, it is assumed, will produce reasonable compensation outcomes as a result of public pressure, particularly by shareholders.

The existing Ontario securities law requirements, introduced in 1994, require companies to provide certain information, including a summary compensation table, and some pension plan information. The Ontario Securities Commission and other Canadian Securities Administrators (CSA Proposals) recently proposed (following new 2006 SEC requirements) to increase the information to be disclosed concerning executive compensation, including the following:

- Full disclosure and quantification of each executive's potential termination benefits
- Changes to pension plan disclosure to show the value of accumulated pension benefits for each executive:
  - Changes in year-over-year value of pension benefits
  - Value of accumulated pension benefits
- Total Compensation, i.e., disclosure of Total Direct Compensation plus Perks, benefits and pensions
- A Compensation Discussion & Analysis setting forth the main principles underlying policies and decisions for compensation to each executive. This would require the board to provide an in-depth disclosure of what it has decided and how and why.

While it is uncertain when, and to what extent, the CSA Proposals will be implemented, they do reflect a widely-held view of the importance of increased disclosure and provide a valuable disclosure model.

In the case of Crown corporations, there are particular compensation issues not found in the private sector:

- The shareholder is Government and, ultimately the general public, which affects the way transparency and accountability work. As to transparency, the securities laws do not apply unless, as in the case of Hydro One, they have issued debt obligations to public investors. This leaves only the rudimentary requirements of

the *Public Sector Salary Disclosures Act*. As to accountability, instead of relying on shareholder activism to hold the boards of directors accountable, there is the political process whereby competing representatives of the public try to hold the immediate shareholder, the Minister, accountable.

- "There is a public sentiment against paying high salaries or high severance packages." (CICA) There just is.
- If there is a mix of commercial and public policy objectives, what is the appropriate comparator market?
- As to severance packages, there is a particular problem, namely, a huge gap between the courts' concept of "just cause" for dismissal of an employee and the public's perception. This gap means that the boards of Crown corporations sometimes have to make severance payments which the public finds excessive, even if not excessive at law. This, of course, is magnified to the extent that senior management compensation is much greater than that with which the general public is familiar. This often results in a very awkward position for Governments to whom Crown corporations are responsible. They have difficulty explaining severance payments in circumstances where the public assumes that there was just cause for dismissal when, in fact, there was not at law. Government and senior management of Crown corporations may add to this problem by describing the (legally) wrongful dismissal as a "resignation".

## 7. **Specific Compensation Findings**

Our specific findings on senior executive and management compensation at OPG, Hydro One, IESO and OPA are as follows:

- (a) Governance
  - Each has a defined committee of the board responsible for oversight of executive compensation.

- Each has a third party consultant to assist in the determination of executive pay levels
- The boards and compensation committees are tightening their control of compensation practices, for example:
  - IESO provides that 50% of the annual STIP (bonus) is held back and paid out over 3 years as a disincentive to leave (a “best practice”)
  - in 2004, OPG made a number of changes, including reducing incentive levels under its STIP, reducing the maximum available award by 50%, and eliminating its LTIP, resulting in an 11% reduction in overall compensation.

(b) Compensation Philosophy

- Each has a specific philosophy focused on an “attract, retain and reward” philosophy for executive compensation.
- In general, there is a strong focus on performance-based incentive pay.

(c) Comparator Groups

There appears to be a bias in favour of utility/energy organizations in the private sector. Furthermore, we note that:

- OPG and Hydro One supplement the energy sector with a broader private sector profile (e.g. telecommunications, financial services and transportation)
- To the extent public sector organizations are used as comparators, it is almost exclusively Canadian utilities (e.g. Hydro Quebec, BC. Hydro and Atomic Energy of Canada), and there is only very limited use of a broader public sector group (e.g. Ontario Public Service, provincial and federal Crown corporations or agencies and regulators).

(d) Positioning

- There is a bias toward the 75<sup>th</sup> percentile of the comparator group, and the use of Total Direct Compensation (base salary, STIP and LTIP) for comparison purposes.
- While the Institutions do not pay LTIP, they cannot escape its impact. All except OPA include LTIP from the private sector comparator organizations in the comparator number, which has the potentially perverse effect of increasing base pay and/or STIP. In any event, potential outside hires may demand additional short-term pay for giving up potential long-term pay.
- The base salary ranges are quite wide and, furthermore, there appear to be a number of instances where people are paid a base salary that exceeds the prescribed base salary maximum, neither of which is a recommended practice.

(e) The Chief Executive Officers (CEOs) are compensated at a level much higher than their comparator groups in the public sector.

When compared with the private utilities sector, only Hydro One and OPG are comparable on Total Cash Compensation while each of IESO and OPA is significantly below. When LTIP is included, all organizations fall significantly below the private utility sector, notwithstanding the effect of including LTIPs in calculating the target total cash compensation.

(f) The top vice-president level across the Institutions is also much higher than that in the comparator public sector markets.

However, each of the Institutions, except OPG, is below the selected utilities and energy comparator market on Total Cash Compensation and all of the Institutions are below market on Total Direct Compensation.

- (g) Overall, the combined effect of the private sector bias in the comparator groups, and the positioning within those groups at the 75<sup>th</sup> percentile for target pay, is to inflate compensation levels.
- (h) Benefits, Pensions and Perks
- Benefits, pensions and perks typically form a higher proportion of Total Compensation in the public sector (35 - 45%) than in the private sector (25 – 35%), where there is greater emphasis on incentive pay, particularly LTIPs.
  - Perks are not significant in absolute dollars, but are troublesome because they may imply special privileges.
  - While specific actuarial values were not determined, a number of Institutions acknowledged that their benefits and pensions are generous. SERPs are common. Our own assessment confirms that pensions are very generous. Deloitte estimates that the value of pension benefits for a typical executive can be as high as 20 – 40% of salary or, in some cases, twice as much (when the executive is given two years of “credited service” for each year of actual employment).
  - In mixing features of public and private sector pension benefits, instead of reaching an appropriate balance there may be an accumulation of features that results in excessive pensions.
  - There are a number of cases where special allowances in the order of \$20-50,000 were identified but not defined.
  - Because we could not determine the cost (in particular) of pensions, we could not determine Total Compensation for senior executives at the Institutions. Since no Institution includes LTIP, the findings only go so far as Total Cash Compensation. Similarly, Deloitte was not able to determine Total Compensation for the external market due to the difficulty of getting adequate information on pensions. These difficulties should not obscure the importance of valuing

pensions. Furthermore, it should become easier to obtain the information as the new SEC and CSA rules kick in.

(i) Severance Pay (Termination)

Practices for severance pay (termination) do appear to reflect those in the private sector, which emphasize the significance of our earlier comment about the gap between the public's expectations and the courts' rulings.

## 8. **Recommendations**

If the benefits of utilizing Crown corporations are to be achieved, there must be clarity of roles and responsibilities of the respective actors in the system:

- Legislature
- Government
- Crown Corporations

Without this clarity and, particularly, if Government is seen to be interfering with the roles of the Boards of Directors, it will be difficult to attract capable and independent directors, to the loss of the system and the public. On the other hand, corporate boards must be held accountable for the achievement of their mandated business goals.

We have the following specific recommendations:

1. The comparator group for senior management compensation at OEB in the future should be of comparable regulatory organizations in Ontario.
2. "Perks" should be discouraged as they raise more questions than they are worth.
3. As part of the governance hierarchy, it would be appropriate, and indeed, helpful to the boards of directors of Hydro One, OPG, IESO and OPA, for the Government to indicate the general principles or broad guidelines to be followed in deciding on compensation to

reflect the mixed commercial and public interest nature of jobs at these Institutions. We recommend the following guideline:

In determining compensation for their executives and senior managers, the Boards of directors of OPG, Hydro One, IESO and OPA shall:

- (a) Focus on Total Compensation, that is, the aggregate of base salary, STIP, benefits and pensions.
- (b) Ensure that all elements of individual pension benefits are clearly understood and not excessive in relation to Total Compensation.
- (c) If reference is made to comparator groups:
  - Have careful regard for appropriate comparator organizations in the public and private sectors of similar size, scope and complexity.
  - Provide a 50/50 weighting of such private and public sector organizations in the determination of Total Direct Compensation and Total Compensation.
  - Reference the 50<sup>th</sup> percentile of the compensation levels at such comparator organizations to determine the level of Total Compensation, while allowing for above 50<sup>th</sup> percentile STIP rewards for measurable superior individual and organizational performance.

Notwithstanding the foregoing, the Boards may deviate from such comparator group principles in exceptional circumstances, namely, if and to the extent there is a measurable or demonstrable shortage of talent available at the compensation levels provided by such principles.

The "exceptional circumstances" clause recognizes that, while the proposed guidelines ask the Institutions to pay at levels more modest than some of their comparators from the private sector, the Institutions perform essential public services. Accordingly, they may

pay above the guideline level if it is clearly necessary to do so to perform these services adequately. But they would have to justify it publicly.

The Panel asked Deloitte to prepare sample calculations based upon a comparator group consisting of a mix of public and private sector organizations. The public sector included utilities, agencies and Crown corporations. The private sector included energy and utility companies. Assuming that target organizational and individual performance levels are achieved, these calculations indicated that approximate Total Cash Compensation (base salary and annual incentive pay) would be in the order of 25% – 30% lower than that now at OPG and Hydro One.

4. The Government should issue a guideline to the Institutions that they further improve the processes to be followed by their compensation committees and boards as follows:
  - The compensation committee of the Board should include at least one member with financial expertise and at least one member with human resources compensation literacy.
  - There should be an independent third party consultant available to the committee.
5. An enhanced state-of-the-art disclosure system for senior executive compensation at OPG, Hydro One, IESO and OSA should be mandated as follows:
  - (b) Their annual reports shall contain the requisite disclosure, and such reports should be available for public tabling before, or at the same time as, disclosure required under the *Public Sector Salary Disclosure Act*.
  - (c) The disclosure system should, at a minimum, include the requirements, from time to time, of the *Securities Act*.
  - (d) There should be full disclosure of those involved in the process and the description of how they were involved.

- (e) There should be clear and full disclosure of the metrics (both quantitative and qualitative) used to measure senior executives, their performance and how this impacts their compensation.
- (f) Disclosure should be made in plain language and disclosure tables should be used for ease of understanding and comparison across organizations in accordance with the following:
- (i) Single table. To ensure that readers understand the Total Compensation being provided by the company, all aspects of compensation and their costs to the organization should be presented in a single, easy to read table.
  - (ii) Choice of Comparators. Clearly and fully identify and rationalize the choice of comparators and disclose any changes in comparators from year to year.
  - (iii) Disclosure of Valuation Methodology. Provide a clear and full discussion of the method of evaluation used for each part of the compensation package so an informed reader can evaluate the process.
  - (iv) Guideline. Describe compliance with the recommended guideline.
  - (v) Pensions. Clearly and fully identify the following information on pension benefits for senior executives:
    - changes in year-over-year value of benefits, and
    - value of accumulated benefits, andrationalize the extent (if any) to which such pension benefits form a higher proportion of Total Compensation than in the comparator groups.
6. Since the Ontario Securities Commission, which is responsible for the disclosure system under the Securities Act, would not have a role in this disclosure system, the Auditor

General should be mandated to audit all aspects of such disclosure and compliance by the Institutions with such guidelines from time to time at his/her discretion or on the request of the Minister of Energy.

7. The focus for accountability by Crown corporations to ministers and legislative committees should be on their respective boards of directors, not their CEOs (who are accountable to their boards). Accordingly, the board chairs and compensation committee chairs should report to the Minister of Energy and appropriate legislative committees on the compensation of executives and senior management. In the final analysis, these boards should be held responsible for compensation and, if found wanting, Government should rebuke or dismiss them, not their CEOs.

## 9. **Conclusion**

Management compensation at the Institutions is a governance issue for which their boards (and compensation committees) have the primary responsibility. However, as Crown corporations they operate with mixed commercial and public policy objectives and, therefore, in a political context. To this such boards must be sensitive in setting compensation. The Government, for its part, should clearly express its expectations. Our recommendations are generally designed to assist this process.

Specifically, we believe the effect of our recommendations will be to reduce overall compensation in three ways over time:

- (a) The guideline itself should reduce senior management compensation in the order of 25-30% at OPG and Hydro One.
- (b) Greatly increased disclosure of compensation will add discipline to the workings of these boards and committees by emphasizing transparency and accountability.
- (c) There should be lower compensation levels at OEB when it is treated like other regulatory agencies.

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