

## **APPENDIX 4-5 – MERCER COMPENSATION LETTERS**

# MERCER



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29 April 2010

Ms. Lise Galli  
Director, Human Resources & Organizational Development  
Horizon Utilities Corporation  
55 John St. N.  
Hamilton, ON

## **Private & Confidential**

**Subject:** Compensation consulting services on behalf of Horizon

Dear Lise,

As requested, and in preparation of your Ontario Energy Board (OEB) rate filings, the following letter summarizes the scope of work that Mercer has completed for Horizon Utilities Corporation ("Horizon") as it relates to executive and non-executive compensation decisions made for fiscal years 2008 and 2009.

Mercer was first engaged by Horizon in October 2007 to provide a complete market pay review for Horizon's non-bargaining positions, including executives. The purpose of this review was to assess the competitiveness of Horizon's compensation programs and included an analysis of base salaries and incentive levels for all levels and major functions within Horizon. Mercer developed and presented our executive compensation findings to the Chair of the Compensation Committee in December 2007 and finalized our broad based (non-executive) compensation findings for management in March 2008. In the fall of 2008, we conducted a subsequent executive compensation market review for the Chair of the Compensation Committee and revisited our broad based findings, as well as conducted further analysis, for Horizon's Vice President, Corporate Services.

These compensation studies employed standard market analysis methodologies used by Mercer in conducting similar reviews for other organizations. Mercer's analysis relied upon current incumbent compensation data provided to Mercer by Horizon. The competitiveness of current practices included comparisons to a variety of external market sources including proprietary Mercer compensation surveys, market survey data provided to Horizon by HayGroup, and other data sources available to Horizon. In addition to the compensation competitiveness benchmarking, Mercer also reviewed the Company's compensation philosophy.

As is typical with market compensation reviews, market comparators for the non-bargaining unit compensation levels were selected based on a sample of regional as well as national organizations with revenues comparable to Horizon. In order to facilitate a comparison to the non-utility sector, we have excluded flow-through revenues (i.e., the cost of electricity) from the revenue scoping to provide a comparison on a similar value-add basis. By doing so, the review excluded large companies whose compensation levels would have likely been significantly higher than those at the companies used in this review.

Over the past two years, Horizon has made a considerable change in its approach to compensation for management and professional employees, moving towards a market competitive pay for performance compensation model. In reviewing Horizon's pay policy structure and compensation philosophy, further discussion was required and Mercer provided commentary and recommendations as to how it could be better aligned to the market.

## **Market Analysis Methodology**

This section outlines the methodology used to benchmark the competitiveness of Horizon's pay policy. Mercer benchmarked target and actual compensation levels within the executive, management and professional employees of Horizon. Cash compensation levels (i.e., base salary and annual incentives) tend to be aligned with the scope and complexity of the individual position and, as such to the extent possible we analyzed market data specific to the individual position.

The goal of any competitiveness review is to map a reasonable sample of Horizon's positions to an appropriate competitive data source(s) and document the relative positioning and identify any misalignments. To accomplish this, Mercer considered a variety of data sources and made best efforts to map as many positions as practical to the market.

Mercer notes that all of the survey sources used in these analyses were based on Canadian data only from Mercer's Canadian Mercer Benchmark Database (MBD). We did not reference the US market as this would be beyond the scope of a typical market review; furthermore, we note that the US market typically exhibits different pay structures and practices than the Canadian market.



### ***Market Analysis and Comparator Markets***

Cash compensation surveys are conducted annually by Mercer and other firms to provide data on a wide range of compensation practices in the market. The most typical methodology requests participating organizations match their jobs to established benchmark job descriptions in the survey. Once a reasonable match has been identified, the participating organization then submits the current compensation levels (base salary, job rate, bonus award, target bonus, etc.) for all incumbents in the respective jobs.

In addition to compensation data, companies also provide specific organizational characteristics which enable Mercer to segment the survey results in order to create data samples that are relevant to the scope and complexity of the company being analyzed (i.e., Horizon). Typically, the data is segmented by industry, and by organization size, usually measured by revenue.

To provide an objective analysis, several data sources (e.g., Mercer's survey data, proprietary survey data, publicly disclosed data, etc.) are often used to provide independent views of the market. We note, however, that these data sources represent different samples and methodologies such that simple aggregation of the results is generally not appropriate.

When analyzing companies, the typical market practice is to consider companies that are one-half to two times the revenue of the target company (i.e., Horizon) – this range is generally considered an appropriate estimate of the scope and complexity of the organization. For purposes of this analysis, Mercer has reduced the overall revenue of Horizon for comparison purposes by the approximate amount of flow-through revenue. This reduced revenue scope better approximates the value-added of the business, and provides a conservative view of the pay market. For some positions that have accountability for managing total revenue, however, we do note that this reduced revenue range may understate the scope, i.e., finance, treasury positions, and we provided a view of the market that considers Horizon's total revenue (i.e., includes the cost of electricity).

For purposes of market analyses, Horizon positions were compared to three data sources:

- i) National private sector in a variety of industries with annual revenues comparable to Horizon – based on data in the MBD;

- ii) National public sector and not-for-profit organizations – based on data in the MBD; and
- iii) A sample of utility sector organizations from HayGroup.

While we note that the competitive market for the majority of non-bargaining positions covered by this review is the national revenue scope, we have provided pay data for the Utilities sector to provide further context. Mercer based our assessment of the competitiveness of the Horizon's compensation levels as follows:

- Core business functions (i.e., CEO, Operations, Customer Service): blend of utility sector data and broader private sector organizations of relevant size, based on revenue
- Corporate functions (i.e., CFO, Corporate Services, Business Development): blend of broader public sector and private sector organizations of relevant size, based on revenue

## **Summary of Work**

The following section summarizes the work conducted by Mercer based on projects and analyses outlined above.

### ***December 2007***

- Executive Compensation Analysis (6 executive positions)
- Pay for Performance discussion
- Compensation Philosophy development discussion

### ***March 2008***

- Broad Based Compensation Review (30 non-bargaining, non-executive positions)
  - As discussed with the Horizon Board and in accordance with Mercer's recommendations regarding compensation strategy, it was agreed that Horizon's compensation levels should be competitive with the market median of a blend of the public sector and private sector comparator organizations
- Recommended salary increase, given market validation of salary levels: 2.5% - 3.0%

### **November 2008**

#### **2008 Compensation Plan Recommendations**

- In response to the recommendations provided to Horizon in the Broad Based Compensation Review conducted in March 2008, Horizon asked Mercer to assist with the following:
  - developing a new salary structure for non-bargaining employees;
  - developing incentive targets based on the recommended salary structure;
  - maintaining the current total cash opportunity when slotting positions into the new salary structure;
  - recommending processes and approaches to assessing and linking pay to performance (included merit pay and annual incentives); and,
  - providing market data with respect to select pay policies and practices (e.g., overtime, vacation, etc.)
- Effective January 1, 2009, Mercer recommended a salary adjustment of 2.8% to Horizon's salary structure

#### **Executive Compensation Analysis**

- Benchmarking review of six executive positions (President & CEO, and each of the CEO's direct reports)
  - Initial findings reviewed with Chair of the Governance Committee and market data for CEO's direct reports reviewed with the CEO.

### **2009 – 2010**

#### **Ongoing Compensation Consulting Services**

Mercer has continued to provide Horizon with ongoing compensation consulting services beyond the deliverables outlined in this letter. These projects were conducted by Mercer in late 2008 through to 2010 and did not constitute Mercer recommendations, as it related to Horizon's 2008 and 2009 compensation decisions, as follows:

- Ad-hoc market pricings for various non-bargaining positions
- Salary structure adjustment modelling and cost impact analysis
- Discussions regarding considerations for measuring CEO performance and determining short-term incentive objectives



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- Discussions regarding projected salary budget and policy increases for 2009, 2010 and a forecast for 2011

Lise, we trust the information provided is helpful. Please let us know if you have any questions.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael A. Thompson", written over a horizontal line.

Michael A. Thompson  
Partner

Copy:  
Martin Beraldo (Mercer)