



*cutting through complexity*

# Ministry of Energy

## Assessment of Benchmarking Reports from Hydro One

**Confidential – Commercially  
Sensitive Material**

Revised

December 7, 2012



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# How to use this document

The Ministry of Energy engaged KPMG undertake a critical review, assessment and summary of existing compensation, efficiency and productivity benchmarking studies that have been completed on Hydro One.

Our role was to assess appropriateness of each benchmarking report, identify gaps and rank Hydro One against its relative peer group. These comments, by their nature, may be critical as they relate solely to opportunities for change or enhancement and will not address the many strong features of the OPG's current activities and undertakings.

Our procedures consisted solely of inquiry, observation, comparison and analysis of Hydro One provided information. We relied on the completeness and accuracy of the information provided. Such work does not constitute an audit. Accordingly, we have expressed no opinion on financial results, internal control or other information.

Our analysis and advice is intended solely for the Ministry's Senior Management's internal use and may not be edited, distributed, published or relied on by any other person.

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# Executive Summary

**The Ministry of Energy engaged KPMG to assess existing benchmarking studies and to identify organizational and structural opportunities for cost savings at Hydro One and OPG.**

The scope of work was to address four main objectives:

- Review and analyze existing benchmarks on compensation, productivity and efficiency
- Identify organizational and structural opportunities for efficiency improvements and Hydro One and OPG
- Prepare a high level 2-3 year plan for improving efficiency without sacrificing reliability and safety
- Develop an analysis that will identify impacts on rate-payers.

This report contains the review of existing benchmarking reports on efficiency, productivity and compensation from Hydro One. From the RFP, this report represents deliverables #1 and #2.

Of the eighteen reports provided by Hydro One, one report was used in our benchmark report evaluation covering one functional area, Compensation. Although many reports were provided by Hydro One, most could not be used in our analysis. Some reports were more than five years old and outside the review timeframe, some reports did not contain benchmarking data and some reports pertained to areas outside the scope of the study.

Of the reports provided, we found that i) reports did not exist for all business functions and therefore some business functions such as Hydro have not been reviewed in this study ii) in business functions where reports existed, some reports did not review all sub-functions and iii) some reports provided summary benchmarks at a function level while other reports provided detailed benchmarks at the function, sub-function and activity level.

Given the constraints listed above, the benchmark report evaluation does not cover all business functions and our analysis is also restricted to the level of detail provided by the reports and therefore varies significantly across each business area.

The shortage of data impacted the method in which we planned to identify potential opportunity areas. As a result, an alternate approach was taken to identifying opportunity areas which included significantly more primary data analysis and additional interviews to compare and evaluate operating models for each business function. The outputs from this approach are detailed in a supplementary report, "Assessment of Structural and Organizational Opportunities at Hydro One".

# Executive Summary

## Benchmarking Report Assessment - Compensation

Compensation Benchmark Report Summary			
Report	Methodology Appropriateness	Metrics	Trend Analysis
<b>Compensation Cost Benchmarking Study - Mercer</b>	<ul style="list-style-type: none"> <li>■ Methodology is appropriate</li> <li>■ Compared against 13 Canadian Utilities</li> <li>■ Comparison represents 49% of Hydro One employees</li> </ul>	<ul style="list-style-type: none"> <li>■ Metrics used are appropriate</li> <li>■ Basis of comparison is <u>job type</u></li> <li>■ Comparison by job type and level would allow for better comparison of specific roles</li> </ul>	<ul style="list-style-type: none"> <li>■ Although the differential has declined since 2008, Hydro One employees are compensated above the median of 13 comparator companies</li> <li>■ Non-represented employees continue to be paid less than the median while represented employees continue to be paid more than the median</li> </ul>
<b>Labour Rates for Hydro One - Hay Group</b>	<ul style="list-style-type: none"> <li>■ Methodology is appropriate</li> <li>■ 30 companies were included in the peer group</li> <li>■ The Hay Group uses a 50/50 blend of industry and similar sized peers</li> <li>■ Compares all bands except for CEO level</li> </ul>	<ul style="list-style-type: none"> <li>■ Metrics used are appropriate</li> <li>■ Basis of comparison is <u>band level</u></li> <li>■ Comparison by level and job type would allow for better comparison of specific roles</li> </ul>	<ul style="list-style-type: none"> <li>■ Year over year analysis was not provided</li> <li>■ In 2011, higher band (2-4) employees are paid less than the median while lower band staff (5-11) employees are paid more than the median</li> </ul>

# Introduction

The provincial government announced plans in the 2012 Ontario Budget to move forward with a comprehensive review of the electricity sector and its various agencies. One element of the review is an independent, critical review and assessment of existing benchmarking at Hydro One and OPG in an effort to improve efficiency and find additional value for rate-payers and the Province.

The Ministry of Energy engaged KPMG to assess existing benchmarking studies and to identify organizational and structural opportunities for efficiencies at Hydro One and OPG.

The scope of work was to address four main objectives:

1. Review and analyze existing benchmarks on compensation, productivity and efficiency
  - Part of the review was to identify any material gaps in the existing benchmarking studies and provide recommendations to address these gaps
2. Identify organizational and structural opportunities for efficiency improvements and Hydro One and OPG
  - Opportunities may include but are not limited to contracting out, and operational and divisional alignments
3. Prepare a high level 2-3 year plan for improving efficiency without sacrificing reliability and safety
  - This plan would identify key steps focused on achieving improvements along key metrics and benchmarked rankings that would create efficiencies and attain greater savings
4. Develop an analysis that will identify impacts on rate-payers.

The scope of this analysis includes the following Hydro One business areas:

- Transmission
- Distribution
- IT
- HR
- Finance
- Compensation

This report contains the review of efficiency, productivity and compensation benchmarking reports from Hydro One. From the RFP, this report represents deliverables #1 and #2.

The background features a complex geometric design with overlapping blue and white shapes. A large, dark blue parallelogram is positioned on the left, partially overlapping a lighter blue shape. To the right, a white trapezoidal area is visible. The overall composition is modern and minimalist.

# **Methodology and Approach**

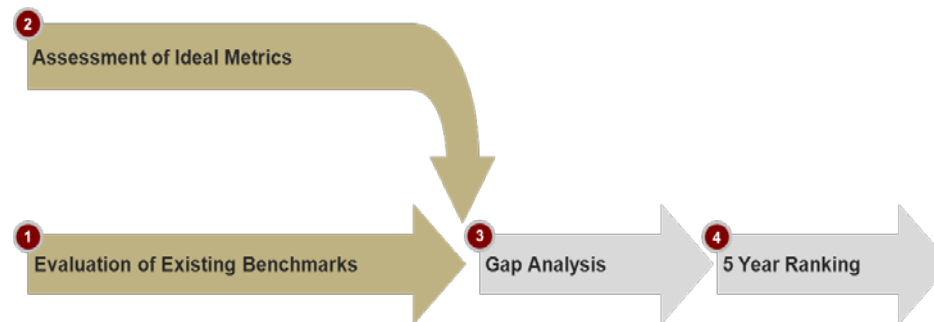


# Our approach to evaluating benchmarking reports from Hydro One

This phase of the project involved preparing an evaluation of benchmarking studies that address compensation, efficiency and productivity at Hydro One.

The evaluation involved identifying any gaps in the existing benchmarking studies, and creating a baseline understanding of Hydro One's performance which was to be used to determine structural and operational efficiency opportunities.

The diagram below illustrates the four steps of the evaluation of each report.



## 1. Evaluation of Existing Benchmarks

The project team reviewed and analyzed the existing benchmarking studies. This included a review of the appropriateness of the methodologies for each report and an evaluation of the quality of the metrics and benchmarks used. The following questions were asked of each report in order to determine the appropriateness of the study:

- Has the business purpose of the benchmarking exercise been clearly defined?
- Was the data collection approach appropriate and not limited by data availability, or other constraints which could limit its quality and comprehensiveness?
- Was the sample size and geographic distribution of the benchmarks appropriately thought through and accounted for?
- Has a normalization of the data, such as currency conversions and labour rate conversions, been implemented to ensure that benchmarks and metrics are as comparable as possible?
- Were there any specific constraints that could skew the interpretation of benchmark comparisons?

# Our approach to evaluating benchmarking reports from Hydro One

## 2. Assessment of Expected Metrics

Based on the scope, purpose and level of depth of each report, the senior members of the project team and advisor group developed a preliminary opinion of the efficiency/productivity metrics and types of peers that they would expect to see. Additionally, the team identified external factors which should be accounted for to ensure a relevant comparison, including operating environments, geographical considerations and environmental issues.

## 3. Gap Analysis

The expected metrics for each respective benchmark report were compared against the actual benchmark report metrics and gaps were identified. The gap metrics represent either areas that are not covered or areas that are insufficiently covered by each benchmark report. Metric gaps were only identified in areas that related to efficiency, productivity or compensation.

## 4. 5-Year Ranking

The project team aggregated each of the key report metrics that related efficiency, productivity or compensation. This year over year analysis was used to evaluate Hydro One's performance over the last 5 years. Where year over year data was not available, key metrics were selected to illustrate in year performance.

# Benchmarking Reports provided by Hydro One

18 reports were provided by Hydro One, two reports were used in our benchmark report evaluation in the subject area of compensation

Hydro One Benchmark Reports		Functional Area											Source	Operational Focus	Within Evaluation Timeline?	Benchmarking report?	In scope?	Used?	Reason
Report Name	Company wide - Compensation	Company wide - Productivity	Transmission	Distribution	IT - Internal	IT - Outsourced	HR - Internal	HR - Outsourced	Finance - Internal	Finance - Outsourced	Administration	Customer Service							
Compensation Cost Benchmarking Study	2008, 2011												Mercer	Compensation	Yes	Yes	Yes	Yes	In-scope
2010 Comparison of Labour Rates and Overtime Policy	2010												Hay Group	Compensation	Yes	Yes	Yes	Yes	In-scope
Compensation Cost Benchmarking Study (Follow up)	2006, 2008	2008											Mercer	Compensation, Productivity/Efficiency	No	Yes	No	No	More recent report used
IT Benchmarking Report					2005								PA Consulting	Productivity/Efficiency	No	Yes	No	No	Age of Report
Distribution Benchmarking Study				2004-2006									PA Consulting	Productivity/Efficiency, Reliability, Safety	No	Yes	Yes	No	Age of Report
Hydro One Update of Transmission Benchmark Study			2004-2006										First Quartile	Productivity/Efficiency, Reliability, Safety	No	Yes	Yes	No	Age of Report
A summary of the High-level Transmission Benchmarking Study			2003-2005										PA Consulting	Productivity/Efficiency, Compensation, Reliability	No	Yes	No	No	Age of Report
Distribution Performance Benchmark Study				2005-2007									First Quartile	Mostly Reliability, Safety	No	Yes	No	No	Age of Report
Hydro One 2009 Safety Survey							2004-2009						Edison Electrical Institute	Safety	Yes	No	No	No	Out of Scope
Hydro One 2010 Safety Survey							2006-2010						Edison Electrical Institute	Safety	Yes	No	No	No	Out of Scope
2011 - Annual Service Continuity Report on Distribution System Performance in Electrical Utility				2006-2010									Canadian Electricity Association	Reliability	Yes	No	No	No	Out of Scope
ERM Hydro One Inc. ERM Leading Practice Review													KPMG	Risk Management	Yes	No	No	No	Out of Scope
2012 SGS Transmission Reliability Benchmarking Study			2006-2011										SGS Statistical Service	Reliability, Safety	Yes	Yes	No	No	Out of Scope
Hydro One Transmission Cost Efficiency/Productivity			2009-2012										Internal	Efficiency/Productivity	Yes	No	No	No	Benchmarks not provided
Transmission Business Performance			2002-2009										Internal	Safety, Reliability, Customer Satisfaction, Shareholder Value, Productivity	Yes	Yes	No	No	Benchmarks not provided
Measuring Productivity at Hydro One		2009-2011											Oliver Wyman	Productivity/Efficiency	Yes	No	Yes	No	Benchmarks not provided
Hydro One Inergi Price Benchmark Report (2007)						2007-2009		2007-2009		2007-2009	2007-2009	2007-2009	Compass/Utilipoint	Productivity/Efficiency	Yes	No	No	No	Benchmarks not provided
Utility Vegetation Management Benchmark & Industry Intelligence				2005-2011									CN Utility Consulting	Productivity/Efficiency, Reliability, Safety	Yes	Yes	Yes	No	H1 Performance not identified in report

# Impacts on our analysis due to availability of data

## Although many reports were provided by Hydro One, several could not be used in our analysis :

- **Age of Reports:** The analysis timeframe for this study, as indicated in the RFP, spanned the past 5 years. Any report that provided data older than 5 years was not used. Major changes in the company in the past 5 years would diminish any insights from the review of these benchmark reports.
- **Benchmarks not provided:** Some reports provided, although informative, did not contain comparisons of Hydro One's performance to benchmarks. Without the benchmarks and Hydro One's performance, we could not evaluate the report in light of the objective of the study.
- **Out of Scope:** The project scope was to review benchmarking reports on *productivity, efficiency and compensation*. Benchmark reports that did not provide these types of metrics were considered out of scope. For example, reports describing the level of uranium supply were provided -- these did not fall within the scope of efficiency, productivity or compensation.

## Additionally, other factors limited the level of data analysis:

- **Span of Business Functions:** Reports did not exist for all business functions. Functions that did not have reports included Transmission and Distribution.
- **Coverage within Business Functions:** In business functions where reports existed, some reports did not review all sub-functions.

## Implication

- Given the constraints listed above the benchmark report evaluation does not cover all business functions. In this report we reviewed the following business functions: Compensation.
- Our analysis is also restricted to the level of detail provided by the reports and therefore varies significantly across each business area
- The shortage of data also impacted the method in which we planned to identify potential opportunity areas since some functions had no benchmark reports to identify improvement areas
- This has required an alternate approach to identify opportunity areas:
  - Significantly more primary data analysis
  - Additional interviews to compare and evaluate operating models for each business function



# **Analysis** *Compensation*

# Compensation - Summary

Compensation Benchmark Report Summary			
Report	Methodology Appropriateness	Metrics	Trend Analysis
<b>Compensation Cost Benchmarking Study - Mercer</b>	<ul style="list-style-type: none"> <li>■ Methodology is appropriate</li> <li>■ Compared against 13 Canadian Utilities</li> <li>■ Comparison represents 49% of Hydro One employees</li> </ul>	<ul style="list-style-type: none"> <li>■ Metrics used are appropriate</li> <li>■ Basis of comparison is band job type</li> <li>■ Comparison by job type and level would allow for better comparison of specific roles</li> </ul>	<ul style="list-style-type: none"> <li>■ Although the differential has declined since 2008, Hydro One employees are compensated above the median of 13 peers</li> <li>■ Non-represented employees continue to be paid less than the median while represented employees continue to be paid more than the median</li> </ul>
<b>Labour Rates for Hydro One - Hay Group</b>	<ul style="list-style-type: none"> <li>■ Methodology is appropriate</li> <li>■ 30 companies were included in the peer group</li> <li>■ The Hay Group uses a 50/50 blend of industry and similar sized peers</li> </ul>	<ul style="list-style-type: none"> <li>■ Metrics used are appropriate</li> <li>■ Basis of comparison is band level</li> <li>■ Comparison by level and job type would allow for better comparison of specific roles</li> </ul>	<ul style="list-style-type: none"> <li>■ Year over year data was not provided</li> <li>■ In 2011, higher band (2-4) employees are paid less than the median while lower band staff (5-11) employees are paid more than the median</li> </ul>

# Compensation: Compensation Cost Benchmarking Study

## Methodology Review

Report Name: Compensation Cost Benchmarking Study			
Study Author	Mercer	Benchmark Types	Compensation
Area of Study	Human Resources Metrics (compensation portion)	Date Published	December 19, 2011
Survey Period	2008-2011		

Appropriateness of Methodology	<p><b>Objective</b></p> <ul style="list-style-type: none"> <li>There is a clear objective, which is to prepare a market-based assessment of the reasonableness of H1's total compensation levels including salary, short-term incentives, long term incentives, pension and benefits relative to select peers</li> </ul> <p><b>Data Collection Method</b></p> <ul style="list-style-type: none"> <li>The data collection is from a survey 3300 H1 employees in 32 positions (49% of Hydro One employees)</li> </ul> <p><b>Peer Group</b></p> <ul style="list-style-type: none"> <li>13 comparable Canadian utility companies are used</li> <li>Peers are comparable in revenue and size</li> </ul> <p><b>Constraints or Limitations</b></p> <ul style="list-style-type: none"> <li>Results are weighted and adjusted</li> <li>Outlines who is included and clearly states the surveying guidelines</li> </ul> <p>The approach and methodology are appropriate for the purpose of the report which was to collect data and compare against industry benchmark performance.</p>
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# Compensation: Compensation Cost Benchmarking Study

## Metric Review

Functional Area	Metrics	Appropriateness	Evaluation of Metric
Compensation	<i>Total Cash By Job Type Relative to Market P50(Median)</i>	Appropriate	<ul style="list-style-type: none"> <li>Appropriate metric to evaluate how total employee compensation ranks when considering short term incentives such as bonuses</li> </ul>
	<i>Total Cash By Job Type Relative to Market Average</i>	Appropriate	<ul style="list-style-type: none"> <li>Appropriate metric to evaluate how total employee compensation ranks when considering short term incentives such as bones</li> </ul>
	<i>Base Salary by Job Type Relative to Market P50(Median)</i>	Appropriate	<ul style="list-style-type: none"> <li>Appropriate metric to evaluate how base compensation ranks against peers relative to the median salary</li> </ul>
	<i>Base Salary by Job Type Relative to Market Average</i>	Appropriate	<ul style="list-style-type: none"> <li>Appropriate metric to evaluate how base compensation ranks against peers relative to the average salary</li> </ul>
	<i>Total Current Compensation by Job Type Relative to Market P50(Median)</i>	Appropriate	<ul style="list-style-type: none"> <li>Appropriate metric for companies to evaluate base compensation plus benefit and pension eligibility</li> <li>Can determine how competitive compensation is under their old pension program</li> </ul>
	<i>Total Current Compensation by Job Type Relative to Market Average</i>	Appropriate	<ul style="list-style-type: none"> <li>Appropriate metric for companies to evaluate base compensation plus benefit and pension eligibility</li> <li>Can determine how competitive compensation is under their old pension program</li> </ul>
	<i>Total Future Compensation by Job Type Relative to Market P50(Median)</i>	Appropriate	<ul style="list-style-type: none"> <li>Appropriate metric for companies to evaluate base compensation plus benefit and pension eligibility</li> <li>Can determine if the impact of a new pension program to market rates</li> </ul>
	<i>Total Future Compensation by Job Type Relative to Market Average</i>	Appropriate	<ul style="list-style-type: none"> <li>Appropriate metric for companies to evaluate base compensation plus benefit and pension eligibility</li> <li>Can determine if the impact of a new pension program to market rates</li> </ul>



# Compensation: Compensation Cost Benchmarking Study

## Metric Gap Analysis

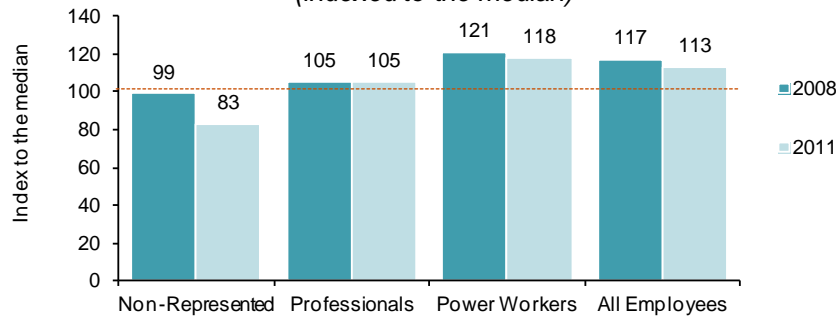
***Based on our review of the report, the following metric gaps were identified as an important area to consider in measuring compensation at Hydro One. The additional metrics are recommended to provide better granularity in comparing roles across the industry.***

Functional Area	Metric Gap	Recommended Metric to Close Gap
Compensation	<b>Base salary by Level</b> <ul style="list-style-type: none"> <li>Important to view what you are paying different levels of employees in comparison with industry peers so to ensure you are adequately paying employees and also not overpaying certain employees</li> </ul>	<b>Base Salary by Level</b>
	<b>Base salary plus Bonus Target by Level</b> <ul style="list-style-type: none"> <li>Important to view how different levels of employees are compensated in base and by bonus with industry peers so to ensure you are adequately paying employees and also not overpaying certain employees</li> </ul>	<b>Target Total Cash by Level</b> ( <i>Base Salary plus Bonus Target</i> )
	<b>Base salary plus Bonus plus long term incentives by Level</b> <ul style="list-style-type: none"> <li>Important to view how you are incorporating long-term benefits and incentives to retain different levels of employees and what is needed based on industry peers (also important to use peers from similar locals in terms of benefits expectations)</li> </ul>	<b>Target Total Direct by Level</b> ( <i>Target Total Cash plus long term incentives</i> )
	<b>Total Target Remuneration by Level</b> <ul style="list-style-type: none"> <li>Important to view the total remuneration of different types of employees with industry peers</li> </ul>	<b>Target Total Remuneration by Level</b> ( <i>Target Total Direct plus Non-Cash</i> )
	<b>Overtime Expense</b> <ul style="list-style-type: none"> <li>Highlights how much of the total labour expense is made up of overtime dollars</li> </ul>	<b>Overtime Expense Ratio</b>

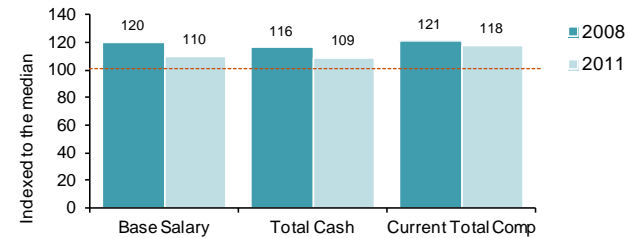
# Compensation: Compensation Cost Benchmarking Study

## Ranking Analysis – Hydro One Employee Types Indexed to the Median

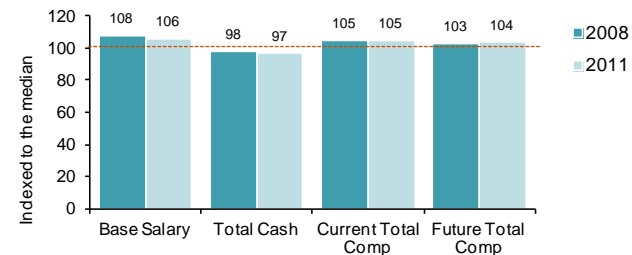
**All Hydro One Employees**  
(indexed to the median)



**Power Workers** (indexed to the median)



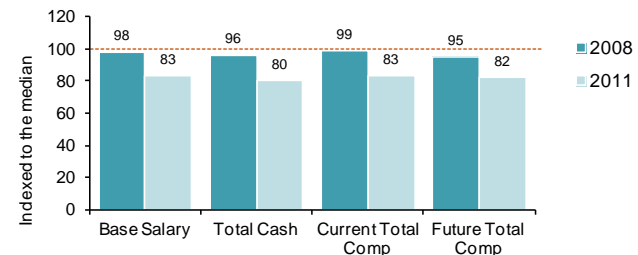
**Professionals** (indexed to the median)



### Trend Analysis

- Although the differential has declined since 2008, Hydro One employees are compensated above the median of 13 peers
- Power workers were identified as compensated the highest above the median
- Non-represented employees are paid less than the median with the gap to the median increasing between 2008 to 2011

**Non-Represented** (indexed to the median)



# Compensation: Labour Rates for Hydro One

## Methodology Review

Report Name: Labour Rates for Hydro One			
Study Author	Hay Group	Benchmark Types	Compensation
Area of Study	Human Resources Metrics (compensation portion)	Date Published	N/A
Survey Period	2011		

Appropriateness of Methodology	<p><b>Objective</b></p> <ul style="list-style-type: none"> <li>There is a clear objective, which is to evaluate pay bands of Hydro One against its peers</li> </ul> <p><b>Data Collection Method</b></p> <ul style="list-style-type: none"> <li>The data collection is by Hay Group for comparators through internal surveys and databases</li> </ul> <p><b>Peer Group</b></p> <ul style="list-style-type: none"> <li>30 companies were included in the peer group</li> <li>The Hay Group uses a 50/50 blend of industry and similar sized peers</li> </ul> <p><b>Constraints or Limitations</b></p> <ul style="list-style-type: none"> <li>No explanation in document provided regarding how roles were mapped to bands across industries</li> </ul> <p>The approach and methodology are appropriate for the purpose of the report which was to collect data and compare against industry benchmark performance.</p>
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# Compensation: Labour Rates for Hydro One

## Metric Review

Functional Area	Metrics	Appropriateness	Evaluation of Metric
Compensation	<i>Base Salary by Level</i>	<b>Appropriate</b>	<ul style="list-style-type: none"> <li>Appropriate standard compensation metric comparing base salary against the median salary</li> </ul>
	<i>Target Total Cash by level (Actual Base Salary plus Bonus Target)</i>	<b>Appropriate</b>	<ul style="list-style-type: none"> <li>Appropriate standard compensation metric comparing base salary and bonus target against the median salary</li> </ul>
	<i>Target Total Direct by level (Target Total Cash plus long term incentives)</i>	<b>Appropriate</b>	<ul style="list-style-type: none"> <li>Appropriate standard compensation metric comparing total direct compensation against the median salary</li> </ul>
	<i>Target Total Remuneration by level (Target Total Direct plus Non-Cash)</i>	<b>Appropriate</b>	<ul style="list-style-type: none"> <li>Appropriate standard compensation metric comparing total remuneration against the median salary</li> <li>Non-cash is assumed to be benefits</li> </ul>

# Compensation: Labour Rates for Hydro One

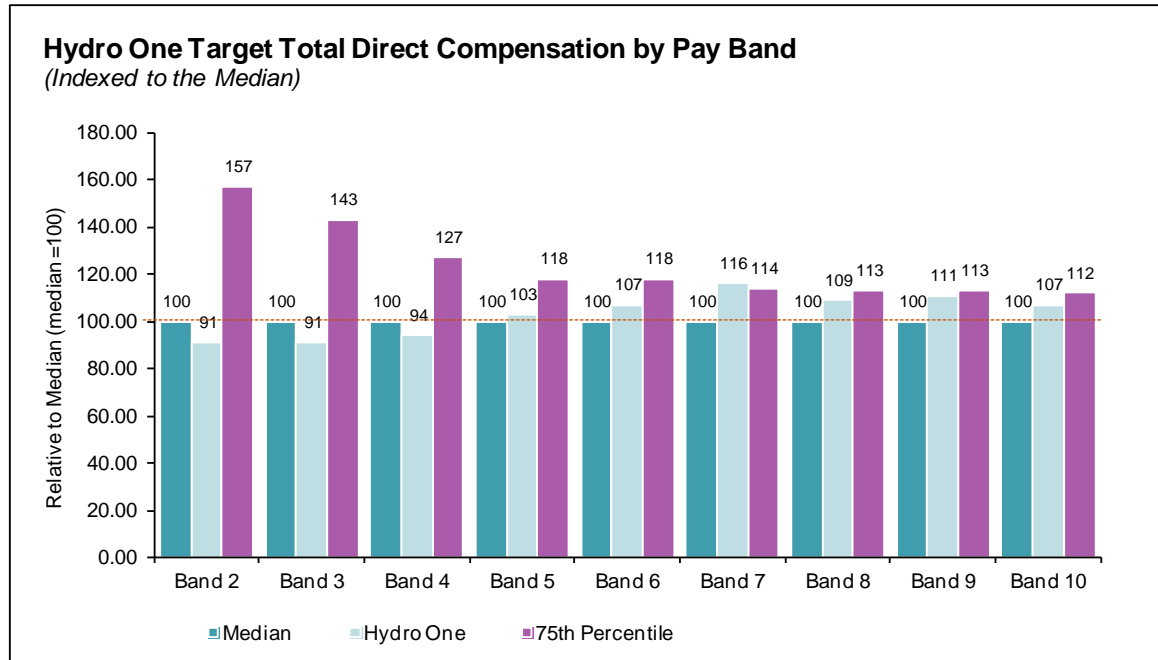
## Metric Gap Analysis

***Based on our review of the report, the following metric gaps were identified as an important area to consider in measuring compensation at Hydro One. The additional metrics are recommended to provide better granularity in comparing roles across the industry.***

Functional Area	Metric Gap	Recommended Metric to Close Gap
Compensation	<b>Base salary by Job Type</b> <ul style="list-style-type: none"> <li>Important to view what you are paying different types of employees in comparison with industry peers so to ensure you are adequately paying employees and also not overpaying certain employees</li> </ul>	<b>Base Salary by Job Type</b>
	<b>Base salary plus Bonus Target by Job Type</b> <ul style="list-style-type: none"> <li>Important to view how different types of employees are compensated in base and by bonus with industry peers so to ensure you are adequately paying employees and also not overpaying certain employees</li> </ul>	<b>Target Total Cash by Job Type</b> <i>(Base Salary plus Bonus Target)</i>
	<b>Base salary plus Bonus plus long term incentives by Job Type</b> <ul style="list-style-type: none"> <li>Important to view how you are incorporating long-term benefits and incentives to retain different types of employees and what is needed based on industry peers (also important to use peers from similar locals in terms of benefits expectations)</li> </ul>	<b>Target Total Direct by Job</b> <i>(Target Total Cash plus long term incentives)</i>
	<b>Total Target Remuneration by Job Type</b> <ul style="list-style-type: none"> <li>Important to view the total remuneration of different types of employees with industry peers</li> </ul>	<b>Target Total Remuneration by Job Type</b> <i>(Target Total Direct plus Non-Cash)</i>
	<b>Overtime Expense</b> <ul style="list-style-type: none"> <li>Highlights how much of the total labour expense is made up of overtime dollars</li> </ul>	<b>Overtime Expense Ratio</b>

# Compensation: Labour Rates for Hydro One

## Ranking Analysis – Hydro One Employee Types Indexed to the Median



### Analysis

- Year over year data was not provided – this is an analysis of the data provided for 2011
- Hydro One's total direct compensation is below the median for bands 2,3, and 4, and above the median for all other bands
- All Hydro One's pay bands are below the top quartile, i.e. below 75<sup>th</sup> percentile, except for Band 7
- Band 1 (CEO level) was not provided