Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2010-0008

IN THE MATTER OF AN APPLICATION BY

ONTARIO POWER GENERATION INC.

PAYMENT AMOUNTS FOR PRESCRIBED FACILITIES FOR 2011 AND 2012

DECISION WITH REASONS

March 10, 2011

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EB-2010-0008

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O.1998, c.15, (Schedule B);

AND IN THE MATTER OF an application by Ontario Power Generation Inc. pursuant to section 78.1 of the *Ontario Energy Board Act, 1998* for an Order or Orders determining payment amounts for the output of certain of its generating facilities.

BEFORE: Cynthia Chaplin
Presiding Member & Chair

Marika Hare
Member

Cathy Spoel
Member

DECISION WITH REASONS

MARCH 10, 2011

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Appendices:

6 CORPORATE COSTS

6.1 Compensation

The following table summarizes historic and test period compensation levels.

Table 17: Compensation ($ million)

Organization	2007	2008	2009	2010	2011	2012
Nuclear	$1,187.90	$1,206.13	$1,265.01	$1,243.41	$1,196.23	$1,210.84
Regulated Hydro	42.29	45.14	45.47	47.87	50.36	52.73
Allocated Corporate Support	122.19	125.95	128.85	131.41	135.15	138.59
TOTAL REGULATED COSTS	**$1,352.38**	**$1,377.22**	**$1,439.33**	**$1,422.69**	**$1,381.74**	**$1,402.16**

Note1: Includes total wages, benefits, current service cost component of the Pension/OPEB costs and annual incentives.

Note 2: Does not reflect OPG's impact statement

Source: Issue 6.8, Exh. L-1-74

OPG employs approximately 10,000 staff in the regulated business, 95% of which support or are employed in the nuclear business. Of the staff in the regulated business, 90% are unionized: two thirds represented by the PWU and one third by the Society.

OPG stated that, as a result of collective bargaining, the general wage increase for the PWU and Society has been between 2% and 3% for the past number of years. As noted in the application, the forecast wage increase for each test year is 3% for management and 3% for both unions. OPG has forecast an additional 1% increase to account for step progressions and promotions for staff within the unions. OPG's labour agreement with the Society expired on December 31, 2010 and its agreement with the PWU expires on March 31, 2012.

OPG maintained that its staff must be highly skilled and noted that 73% of the positions require post secondary education. OPG indicated that these employees are in demand across the country. The OPG workforce is mature and OPG estimated that 20% to 25% will need to be replaced between 2010 and 2014.

Towers Perrin conducts a survey which compares compensation data among a variety of employers across Canada where job matches are sufficiently strong. Although OPG participates in the Towers Perrin study, the survey is not prepared specifically for OPG.

OPG used the data from the survey to prepare a chart comparing OPG's salary levels with those of other organizations in the survey. Specifically, the chart shows the variance between OPG's salary levels and the 75th percentile of the comparators for 30 positions. OPG selected the positions that were included in the chart based on its judgment of which ones were the best matches.[32] Together, these positions account for approximately 30% of OPG staff who work in the regulated businesses. The chart showed that OPG was above the 75th percentile for some positions, and below it for others, and was slightly above the 75th percentile on an overall basis.[33] OPG selected the 75th percentile as the most appropriate point of comparison (Towers Perrin provided data for the 10th, 25th, 50th, 75th, and 90th percentiles). Towers Perrin did not participate in the preparation of the chart, and did not provide OPG with advice concerning the best comparable positions, or the use of the 75th percentile as a comparator. Although the Towers Perrin survey included data on both base salaries and total cash compensation, the chart prepared by OPG used the base salary data only.

OPG maintained that the compensation for unionized employees is appropriately benchmarked at the 75th percentile of the market for companies surveyed by Towers Perrin due to the nature and complexity of work performed by OPG staff. OPG advised that the 30 positions in the survey accounted for 2,804 OPG employees. In order to bring this set of positions to the 75th percentile, $16 million would have to be removed from payroll, and in order to bring the positions to the 50th percentile, $37.7 million would have to be removed from payroll.

In response to recommendations of the Agency Review Panel,[34] management compensation has declined by 12.6% in the period 2007-2009. OPG benchmarks management compensation against the 50th percentile of market. In the impact statement filed on September 30, 2010, OPG stated that it is removing management wage escalation for the period to April 1, 2012 in response to the *Public Sector Compensation Restraint Act*. OPG proposed to offset the $12 million reduction related to management wages against the $13 million increase in Canadian Nuclear Safety Commission fees. The latter is discussed at section 4.3.1.

The Society and the PWU supported OPG's application. The Society submitted that if the Board believes that a 3% economic increase is unlikely to be granted by an

[32] Tr. Vol. 8, pp. 166-168.
[33] Exh. F4-3-1, pp. 30-31.
[34] The Agency Review Panel's June 27, 2007 report recommended changes to the way executive compensation would be determined at Ontario's five electricity sector institutions, which included OPG.

arbitrator, then it may consider the use of a variance account to capture any amount less than 3%. In the PWU's view, the Board needs to consider whether the current compensation rates for PWU represented staff was reasonable and prudent when the present collective agreement was entered into in April 2009. Regarding comparisons, the PWU submitted that simply comparing OPG compensation with other non-nuclear employers is not evidence of a lack of prudence on the part of OPG. The PWU also submitted that an assessment of compensation requires an assessment of productivity and skill level.

Board staff questioned OPG's choice to benchmark at the 75th percentile, noting that a number of positions OPG selected from the Towers Perrin survey are generic positions (i.e., labourer, warehouse supervisor). In addition, staff noted that OPG was not able to identify any positions that were exclusively related to specialized skills required of an employee working in a nuclear plant environment, because Towers Perrin did not categorize the positions in this way. Staff submitted that the rationale provided by OPG for use of the 75th percentile was not substantiated, and that the 50th percentile is more consistent with the use of the median by the Board in relation to Hydro One.[35] Staff submitted that it was appropriate to remove $37.7 million from annual revenue requirement based on moving the 30 positions to the 50th percentile. Staff also submitted that it was appropriate to reduce the revenue requirement associated with the Society wage increase from 4% to 2.5%, as this was more consistent with recent arbitration decisions entered into evidence by PWU. These arbitration decisions resulted in increases of 2%, 2.25% and 3%.

CME submitted that the Board can assume that the Towers Perrin report is likely representative of all OPG incumbents, and urged the Board to consider higher disallowances than those suggested by Board staff. CME extrapolated the Towers Perrin results to all employees and estimated reductions of $134.48 million assuming reductions to the 50th percentile. CCC supported CME's position.

SEC submitted it would be unfair to require OPG to move to the 50th percentile immediately and proposed a 25% reduction in 2011 (of the total amount required to match the 50th percentile) and 50% in 2012, amounting to reductions of $33.7 million for 2011 and $67.3 million for 2012. SEC observed that where the Board has set limits previously, regulated entities have responded favourably. SEC further proposed the elimination of the licence retention bonus. With respect to the licence retention bonus,

[35] Decision with Reasons, EB-2008-0272, May 28, 2009, pp. 28-31.

OPG maintained that it is appropriate due to the effort and resources required to retain licences and the comparable practice at Bruce Power.

OPG replied that it is bound by its collective agreements and that there is no basis for selecting the 50th percentile as the appropriate benchmark. OPG argued that skills and training requirements are extensive, even for positions viewed as generic by parties. OPG noted that intervenors relied on no evidence to support their view that the 50th percentile was the appropriate target.

With respect to the Ontario Hydro successor companies, OPG provided a wage comparison of OPG to Hydro One for comparable Society positions. Staff entered into evidence a similar comparison for certain PWU positions from the EB-2010-0002 Hydro One application. Board staff submitted that there is no justification for OPG to consistently pay its staff more than Hydro One for generic positions such as mechanical maintainer, regional field mechanic or labourer.

OPG maintained that its compensation compares favourably with the other successor companies, and that on a weighted average basis, OPG's wages are 10% lower than Bruce Power – the only other large nuclear operator in the province.

OPG noted that one Ontario Hydro successor company has undergone arbitration and received a 3% increase excluding progression and promotion. OPG argued that the Board staff position of 2.5% has no basis and that the reduction should be at most 0.5%.

As noted in the section on benchmarking, there was difficulty reviewing compensation data and trends due to OPG's use of headcount for the historical period and FTEs for the future period. Parties were generally of the view that FTEs should be used for all periods. SEC further submitted that OPG should be required to file compensation information in the format of Appendix 2K used for electricity distributors.[36] OPG responded that it would file the equivalent of Appendix 2K which is based on FTEs, to provide historical and forecast data on a comparable basis.

Board staff and SEC also submitted that OPG should be directed to file an independent full compensation study with its next application similar to the study that the Board

[36] Ontario Energy Board, Filing Requirements for Transmission and Distribution Applications, June 28, 2010.

required of Hydro One.[37] Board staff noted that, given total compensation costs of almost $2.8 billion over the test period, the cost of such a study would be reasonable.

OPG argued that an external study of compensation was not required because the study would be expensive, at a cost of about $0.5 million to $1 million, there are a limited number of nuclear operators in Canada, and OPG is bound by its collective agreements. OPG stated that if it was directed to complete a study, it would do so provided funding was allocated.

Board Findings

Compensation makes up a very significant component of OPG's total operating costs. The Board is concerned with both the number of staff and the level of compensation paid in light of the overall performance of the nuclear business. Each of these issues will be addressed separately.

The lack of comparable data (use of headcount for the historical period and FTEs for the future) make comparison and trending of staffing levels difficult. The Board must be able to see proposed staffing levels and compare those to previous period actuals. The Board therefore will direct OPG to file on a FTE basis in its next application and to restate historical years on that basis.

One of the reasons for the discontinuity between headcount and FTEs may be the extensive use of overtime, particularly in the nuclear division. The Board expects to examine the issue of overtime more closely in the next proceeding. The Board expects OPG to demonstrate that it has optimized the mix of potential staffing resources.

Despite this difficulty in comparing proposed staffing levels with past periods, the Board is of the view that OPG has opportunities to reduce the overall number of employees further as a means of controlling total costs and enhancing productivity. This was demonstrated by OPG's own evidence, as explained by OPG's witness and by Mr. Sequeira from ScottMadden, with respect to the Radiation Protection Function.[38]

The ScottMadden Phase 2 report observed that OPG's staffing levels per unit exceed both the industry median and Bruce Power, and that OPG staff levels are generally higher than the comparison panels (while noting that this may be influenced by OPG's

[37] Decision with Reasons, EB-2006-0501, August 16, 2007, p. 33.
[38] Tr. Vol. 3, p. 24.

practice of contracting out relatively few project based outage functions).[39] For this reason, the Board has also directed OPG to conduct a staff level analysis as part of its benchmarking studies for the next proceeding. (This issue is discussed more fully in Section 4.2, Benchmarking.) ScottMadden also conducted a pilot top-down staffing analysis for a single OPG function: the Radiation Protection Function. ScottMadden concluded that there was room for a potential reduction of 48 FTEs (28%) in the Radiation Protection Function, of which 13 FTEs could be eliminated altogether. Despite these findings, OPG failed to act on an opportunity to eliminate 13 FTEs, and instead eliminated only one.[40] This is only a single example concerning relatively few positions, but the Board is concerned that OPG has not acted more aggressively in a case where it has clear information that a particular function is overstaffed. Although collective agreements may make it difficult to eliminate positions quickly, it is not reasonable for ratepayers to bear these additional costs in the face of strong evidence that the positions are in excess of reasonable requirements. With 20 to 25% of staff expected to retire between 2010 and 2014, the Board concludes that OPG has a timely opportunity to review its organizational structure, taking actions to reassign functions and eliminate positions. The Board is not suggesting that a specific percentage of the retiring staff will not need to be replaced, but this may provide an opportunity for reducing the overall staffing complement without disrupting negotiated commitments with the unions.

As to the compensation, the Board finds that the compensation benchmark should generally be set at the 50th percentile. OPG suggests there is no evidence to support this conclusion, but the Board disagrees. This target level is consistent with the recommendations of the Agency Review Panel for executive employees, and indeed for management employees, OPG uses the 50th percentile as the benchmark. In the Board's view, there would need to be strong evidence to conclude that a higher percentile is warranted for non-management staff. OPG provided no such compelling evidence, but merely asserted that positions in the nuclear business required greater skills overall than the comparators. There was no documentation or analysis to support these assertions.

The evidence provided does not substantiate the assertion that the positions selected by OPG are sufficiently different to warrant the use of the 75th percentile. Although OPG stressed that its work requirements (particularly on the nuclear side) are highly

[39] Exh. F5-1-2, p. 26.
[40] Tr. Vol. 3, p. 27.

technical, the Board observes that many of the comparators in the Towers Perrin study would also require highly technical skills, and some of the comparators also operate nuclear facilities. Indeed the job classifications used in the Towers Perrin report are compared against each other on the basis that they are at least broadly speaking comparable. A number of the positions selected by OPG, such as labourer, also do not appear to be specifically related to highly technical nuclear plant work. In addition, most of the comparators were similarly large and unionized, and perform highly technical, though not necessarily nuclear plant, work. The Board recognizes that the analysis conducted by OPG to produce the chart is not comprehensive, and indeed was not likely intended to be comprehensive. Well over half of OPG's employees are not covered by the 30 positions listed in the chart. The data was not specifically prepared for the purpose of conducting a comprehensive comparison, and the data used in preparing the chart references base salary only.[41] Despite these limitations, the analysis provides sufficient evidence to conclude that for a significant proportion of OPG's staff the compensation is excessive based on market comparisons.

PWU argued that the comparative analysis, which uses non-nuclear entities, is not evidence of imprudence by OPG, and therefore there is no evidence to rebut the presumption that the expenses arising from the collective agreements are prudent. The Board does not agree.

The ratepayers should only be required to bear reasonable costs – and in determining reasonable costs the Board can be guided by market comparisons. It is the responsibility of the Board to send a clear signal that OPG must take responsibility for improving its performance. In order to achieve this, the Board will reduce the allowance for nuclear compensation costs by $55 million in 2011. This amount is derived by considering a number of factors:

- Reducing the compensation for the 30 positions from the Towers Perrin data would require a reduction of $37.7 million.
- Given the breadth of positions in the analysis and the prevailing pattern that wages are well in excess of the 50th percentile, it is reasonable to conclude that the same pattern exists for the vast majority of all staff positions in the company. There was certainly no evidence to suggest otherwise. Therefore, the total

[41] The Towers Perrin survey was filed confidentially with the Board as undertaking J8.5. The Towers Perrin Survey includes data both for base salary and total cash compensation. However, OPG appears to have used only the base salary information in preparing the chart. See Tr. Vol. 8, pp. 175-176.

adjustment to move all regulated staff to the 50th percentile is substantially in excess of $37.7 million.

- In determining the appropriate adjustment, the Board recognizes that it will be difficult for OPG to make significant savings through compensation levels alone in the short to medium-term given the collective agreements with its unions.
- OPG has already indicated that there will be no increase in management salaries through April 1, 2012, and this reduction was not incorporated into the original filing.
- The ScottMadden benchmarking analysis supports the conclusion that there is excess staff overall and that this is one component of OPG's relatively poor performance (in comparison to its peers). A further reduction in the allowance for compensation is warranted for this factor.
- The ScottMadden benchmarking analysis also demonstrates that OPG's overall performance is poor on certain key benchmarks, for example non-fuel operating costs. Compensation is a significant cost driver for this metric, and OPG's poor ranking supports the Board's decision to make reductions on account of compensation costs

The same reduction will apply in 2012, but there will also be an additional reduction of $35 million to represent further progress toward the 50th percentile, further progress in reducing excess headcount, and further progress toward achieving a reasonable level of cost performance. The total reduction for 2012 is $90 million.

While a more aggressive reduction was argued by some intervenors, the Board recognizes that changes to union contracts, to staffing levels and movement to the 50th percentile benchmark will take time. Indeed, the Board recognizes that OPG may not be able to achieve $145 million in savings in the test period through compensation reductions alone. The Board is making these adjustments so that payment amounts are based on a reasonable level of performance. If costs are in excess of a reasonable level of performance, then those excess costs are appropriately borne by the shareholder.

The Board is allocating this adjustment solely to the nuclear business for the purposes of setting the payment amounts. The Board is not ordering any reductions for the hydroelectric business because the benchmarking evidence for that business supports the conclusion that it is operated reasonably efficiently from an overall perspective, and therefore the Board is less concerned with the specific compensation levels for that part

of the company. For the nuclear business the evidence is clear that overall performance is poor in comparison to its peers and the staffing levels and compensation exceed the comparators. On this basis an adjustment is necessary to ensure the payment amounts are just and reasonable.

Lastly, the Board directs OPG to conduct an independent compensation study to be filed with the next application. As noted above, OPG's compensation benchmarking analysis to date has not been comprehensive. The Board remains concerned about compensation costs, in light of the company's overall poor nuclear performance, and would be assisted by a comprehensive benchmarking study comparing OPG's total compensation with broadly comparable organizations. The study should cover a significant proportion of its positions. Compensation costs are a signification proportion of the total revenue requirement; OPG's position that such a study would be too expensive and of little value is therefore not reasonable. Consultation with Board staff and stakeholders concerning the scope of the study, in advance of issuing a Terms of Reference, is advised. The costs of the study are to be absorbed within the overall revenue requirement allowed for in this Decision. This has been already accounted for in the Regulatory Affairs budget, which anticipates studies in support of the company's next application.

6.2 Pension and Other Post Employment Benefits

Costs related to Pension and Other Post Employment Benefits ("OPEB") for the test period were forecast based on discount rates and assumptions in OPG's 2010-2014 business plan. The total amount requested for the test period is approximately $633 million. On September 30, 2010, OPG filed an Impact Statement in which it identified a significant decline in discount rates causing an increase in forecast pension and OPEB costs for the test period. Rather than revising the proposed revenue requirement, OPG requested approval for a variance account, "to record the revenue requirement impact of differences between forecast and actual pension and OPEB costs." The total forecast increase as a result of the update is $264.2 million, as summarized in the following table.