Undertaking 13

Undertake to provide a full copy of the Mercer Report found in RFI CA-NLH-266 (Attachment 1)

After discussing the matter with counsel for Mercer, the consulting company that composed the report, and in consideration of the Non-disclosure agreement, Hydro believes it to be appropriate, and it was agreed by the consultant, to disclose portions of the report but to withhold other portions that comprise confidential and sensitive business owned by the consultant. Please see Undertaking 13, Attachment 1.

Below is a list, with brief explanations, of the information provided and not disclosed.

Information Provided:

- Executive Summary – summarizes key findings and proposals.
- Introduction
- Compensation Philosophy – a summary of Nalcor's compensation philosophy, based on interviews of Nalcor executives.
- Summary of Findings and Recommendations (General) -- comparison to other Canadian utility companies.
- Summary of Findings and Recommendations (Head Office, Bull Arm, Churchill, Hydro and Lower Churchill Divisions).

Not Disclosed:

- Methodology – Competitive Review – This section details how Mercer conducts its compensation review projects and constitutes commercially sensitive information belonging to Mercer.
- Summary of Findings and Recommendations (Oil & Gas Division). This is not relevant to the present matter before the Board.
- Appendix A (Market Compensation Detail) – This appendix contains proprietary data that Mercer collected with a specific, limited allowance for its use and disclosure, which did not include the present type of hearing. Mercer has informed Hydro that the data was collected at great expense to Mercer and constitutes information that is commercially sensitive to Mercer.

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11 February 2011

Nalcor Energy
Non-Union Compensation Review

Table of Contents

Executive Summary

- We have reviewed Nalcor's non-union compensation structure relative to three peer groups that encapsulate Nalcor's business units: Utilities, Oil & Gas and a General Industry comparator for lower-level positions common across business units
- We have proposed the adoption of 2 pay scales within Nalcor's existing Hay-05 through Hay-18 compensation structure in order to allow Nalcor to offer market-competitive compensation across its business units
  - Proposed maximum salaries for Utilities business units are 25-43% above current maximums
  - Proposed maximum salaries for Oil & Gas are 32-65% above current maximums
  - Proposed maximum salaries for lower level, General Industry positions are 3-5% above current maximums
- Nalcor's variable pay is generally below market levels of 'at risk' compensation
  - We propose to increase bonus targets for those above Hay-10 (within Oil & Gas), Hay-13 (within Utilities)
  - We recommend eliminating variable pay for Hay-09 and below as the market data does not support this practice; however, we recognize the difficulty in implementing such a change without offering those affected something as an offset
- We suggest the creation of a long-term incentive plan for employees within the Oil & Gas business unit that are at Hay-13 and above

Introduction

- Mercer has been asked by Nalcor Energy ("Nalcor") to provide advice on non-union compensation including:
  - Establishing compensation philosophy
  - Establishing position matches for 78 non-executive, non-union positions
  - Comparator group selection
  - Assessing the competitiveness of base salary, total cash compensation (salary plus short-term incentives) and total direct compensation (total cash plus the annualized value of long-term incentives) for each non-union role and each non-union salary grade
    - Recommending short- and long-term incentive practices in light of prevailing practices in the market
  - Recommending a non-union pay line or pay lines and comparing to existing pay line
  - Researching practices in the utility sector and recommending an approach to establish and maintain front-line supervisor pay differentials
  - Recommending changes where warranted

- This report presents our findings and recommendations

Compensation Philosophy

Compensation Philosophy

- Mercer has interviewed 10 Nalcor executives and, based on our understanding of Nalcor's business strategy, growth ambition, culture and business needs, we have drafted a preliminary compensation philosophy. Mercer has used this preliminary philosophy as the basis to construct compensation recommendations; however, the philosophy needs to be thoroughly discussed within the Nalcor organization. This preliminary philosophy is summarized here:
- Purpose of Compensation
  - Nalcor's compensation programs are designed to:
    - Attract and retain the talent needed by Nalcor to execute on its strategy
    - Position Nalcor's compensation within the competitive range of a comparator group of companies
    - Align employees with the short-term and long-term objectives of the company
    - Rewards performance based on pre-determined and quantifiable goals
- Purpose of Compensation Elements
  - Base salary:
    - Provides a competitive, predictable and secure form of compensation that recognizes the individual's level of responsibility, experience and contribution to the company
  - Variable Pay for level 15 and above (Short-term Incentive):
    - Provides an incentive opportunity that is designed to reward performance relative to a annual predetermined set of goals embedded in the performance contract; as well as behaviour that lend to organizational effectiveness. Consequently actual awards vary based on performance relative to goals and behaviours

Compensation Philosophy (cont'd)

- Purpose of Compensation Elements (cont'd)
  - Long-term Incentive for level 18 and above (when/if implemented)
    - Provides rewards related to the attainment of long-term (3 year) goals. As such the program aligns participants with the long-term interests of the company and serves as a significant retention vehicle
  - Benefits and Retirement Arrangements
    - Provides security pertaining to health, welfare and retirement
- Competitive Positioning
  - Nalcor is comprised of 5 Business Units operating, and in a number of cases competing, in distinct industry sectors. For this reason, Nalcor will establish competitive practices that are industry specific (or perhaps geographically specific, such as Churchill Falls) where a corporate policy is absolutely unworkable
  - Where Business Unit specific programs are required; Nalcor benchmarks competitive practices against the median of a industry specific comparator group
  - Comparators' total compensation (salary, short-term and long-term incentives opportunities) is assessed against Nalcor's total compensation to assess the competitive positioning of cash and equity related rewards
  - Benefits and retirement arrangements are benchmarked separately to ensure reasonableness
  - Executives and corporate staff functions are benchmarked against the median of a group of similar sized companies representing a broad cross section of Canadian industry

Compensation Philosophy (cont'd)

- Performance – Reward Relationship
  - Nalcor fosters a culture of performance and links rewards to performance. Nalcor establishes performance contracts with employees on an annual basis which is used to assess performance
- Recognition and Special Effort
  - Nalcor appreciates and values the behaviours and efforts that add to the Company's efficiency and productivity. Nalcor provides a series to recognition programs to acknowledge varying levels of extra contribution; including company related extraordinary effort / extreme family disruption
- Compensation's Role in Reinforcing Culture
  - Compensation will be aligned with the culture of Nalcor
    - Nalcor is a team-based organization; consequently, the rewards related to the variable compensation program (short-term incentive) will be biased toward team achievements
    - Nalcor values behaviours that add to organizational efficiency; consequently, a portion of the variable compensation program (short-term incentive) rewards appropriate behaviours
    - Nalcor values and rewards behaviours that are in the overall corporate best interest. This will become more important as Business Units grow and become more autonomous
- Internal Versus External Equity
  - Nalcor attempts to balance internal and external equity; however, when forced to choose, Nalcor places more emphasis on external equity (aligning an individual position's compensation with the "market") than internal equity (aligning positions based on the internal perceived value)

Compensation Philosophy (cont'd)

- Cross Business Unit Mobility
  - As certain compensation programs will vary from Business Unit to Business Unit, it is important to have compensation processes that promote (rather than hinder) cross Business Unit mobility. Nalcor will have clear rules as to when and how employees transfer to new Business Unit specific programs
- Employee Choice Related to Benefits
  - Employees' needs vary based on personal circumstances. Nalcor's benefits consist of a core of catastrophic coverage supplemented by some flexible options that are designed to meet individuals' personal needs. We believe that employees will understand and respect the benefits program if they are required to contribute to the costs

Summary of Findings and Recommendations

General

Summary of Findings and Recommendations – General
Variable Pay – STI

- The table below summarizes Nalcor's variable pay practices for short-term incentives compared to Canadian utility companies, providing insight into industry-specific practices:

Variable Pay Type	Nalcor	Market
Short-term Incentives ("STI")	Yes 6% target paid in cash Upside is limited to 9%	78% have broad-based bonus plans; 100% of these have formal bonus targets Field personnel are eligible at 45% of companies that have these positions; 100% of these use the same plan as office employees Directors, managers, team leads and senior professionals are eligible in ~90% of plans Junior technical professionals and senior and junior admin professionals are eligible in ~80% of plans Para professionals (admin and technical support) are eligible in ~60% of plans Median target and maximum bonuses are 22% and 38% (directors), 15% and 23% (managers), 12% and 20% (team leader), 8% and 16% (senior technical professional), 10% and 15% (senior admin professional); other levels have targets of 7-8% maximums of 12-16% 73% of plans provide for a maximum payout of 150-200% of target; 200% is slightly more common than 150%; this policy is generally maintained across non-executive levels that are eligible for STI ~10% pay in deferred cash in addition to immediate cash

- Nalcor should consider adopting formal competitive STI targets for each pay band in each of the pay structures, and providing upside potential in the STI plan of 1.5x or 2.0x target

Summary of Findings and Recommendations – General
Variable Pay – LTI

- The table below summarizes Nalcor's variable pay practices for long-term incentives compared to Canadian utility companies, providing insight into industry-specific practices:

Variable Pay Type	Nalcor	Market
Long-term Incentives ("LTI")	None	50% of respondents grant LTI; the director-level is eligible at 78% of these, manager at 33% and ~10% have a broad-based LTI plan to which all employee levels are eligible Field personnel are not eligible for LTI programs at any of the respondents 55% of respondents with an LTI plan have a cash-based plan 88% of respondents with a plan express target as % of salary Median annual target and maximum value is 23% and 41% for directors; managers have a median target of 13% (insufficient data for additional detail) Share grants cliff vest in 3 years

- Nalcor should consider adopting a cash based LTI plan with a cliff vesting 3-year term
- Only senior roles with the ability to impact corporate performance and/or experiencing strong market pressures should be eligible for LTI

Summary of Findings and Recommendations – General
Perquisites

- The table below summarizes Nalcor's non-executive perquisites compared to Canadian utility companies, providing insight into industry-specific practices :

Perquisite	Nalcor	Market
Vehicle Benefit	No	89% of respondents provide this perquisite; 67% of those responding provide to directors; 38% to managers, 23% to senior technical professionals; 15-17% provide to other employee levels 80% of field supervisors are eligible
Lunch and Country Clubs	No	No respondent provides this perquisite below the executive level
Fitness Club	Yes $250	~29% provide to non-executives; average amount is ~$300 annually
Parking	No	47% provide to director-level and 44% to other non-executives; median annual maximum is $1,660 for directors and $900 for other non-executives
Financial Counseling	No	~10% provide to directors and other non-executives
Flexible Spending Account	No	47% provide to director-level and 33% to other non-executives; median maximum is $1,000 annually (typically excludes vehicles, where provided)

- Vehicle benefits are the most common perquisite that Nalcor does not offer, but these are typically only provided to upper levels (Directors)
- If Nalcor were to consider increasing perquisites for some employee groups, a flexible spending account of about $1,000 could be considered

Summary of Findings and Recommendations – General
Front-Line Supervisor Differentials

- Mercer has gathered information on front-line supervisor pay differential policies and related issues through discussions with 6 utility companies and a review of utility-sector MTCS responses
  - The following page summarizes responses from each participating utility company as well as Nalcor's policies. MTCS survey responses are also aggregated and summarized.
- Observations and recommendations:
  - Nalcor's current supervisor pay differential policy appears market-competitive, suggesting that an unusual degree of compression may be caused by a large amount of overtime
    - Two of the 6 companies surveyed expressed significant concern regarding supervisor compression
    - Refer to the rightmost column on the following page for some alternative approaches to managing pay compression
  - One of the 6 companies surveyed is concerned about compression above the supervisor level
  - Nalcor's acting up policies are at the low end of market practices. We do not see a market imperative to increase this aspect of compensation unless there are internal difficulties in filling these temporary assignments.
  - Supervisor overtime is competitive, as is the policy for those above the supervisor level to be ineligible for overtime

- Nalcor's policies on front-line supervisor differentials, acting pay and supervisor overtime are reasonable given market practices
- Nalcor could consider adopting some of the alternatives methods of mitigating the effects of compression (e.g., car allowances or more flexible work arrangements)

Summary of Findings and Rec. – General
Front-Line Supervisor Differentials (cont'd)

Front-line supervisor differentials measure the target or actual difference between a supervisor and his/her highest paid subordinate. Actual or assumed subordinate overtime may be included, as indicated.

	Target Front-Line Supervisor Differential	Acting Up	Supervisor Leave in Lieu of Overtime	Compression Above Front-Line	Comments/Mitigation Strategies
Company A	10% (no OT included; includes shift differential)	80% of acting role's pay grade if will be longer than 2 weeks; may be additional compensation if moved up for succession planning, etc.	1x (pensionable for those supervising unionized staff)	Maintaining 10% differential is manageable; make one-off adjustments where necessary	None provided
Company B	7% for new supervisors (no OT or merit-based pay included); average actual differential is 11-12%	Union: 5% increase for one grade; 8% for two grades; 7-10% if filling in for non-union supervisor	2x for the approximately 1/3 of supervisors in lower pay grades; others are not eligible for overtime	Not experiencing above supervisor	Greater flexibility in time for those outside of union; some supervisors have use of unmarked company vehicle
Company C	10% (no OT included; where a subordinate is above proscribed grade, there is a 5% minimum differential)	Standard 5% increase (6 weeks to qualify; retroactively paid if not planned)	2x; offer %ge increase based on estimated OT where supervisor will be subject to OT on very regular basis	Yes, compression issue from VPs down	Have paid OT for outage-type situations; expanded lead-hand (5% raise) to put more supervision into trades people
Company D	Majority are unionized; hourly wage rate differentials set by collective bargaining agreement and range from 5% to 15% Non-union supervisors can be moved up a pay band	Union: 8% if acting assignment is non-supervisory; 10% when acting in a supervisory role Non-union: 5% increase if added significant responsibility; 10% increase if acting assignment is at a higher pay rate	Majority are unionized; overtime rate set by collective bargaining agreement Non-union: nothing in lieu of overtime	Can deal with compression by moving certain supervisors to next pay band	Review opportunities to remove organizational layers
Company E	10% (OT and bonus opportunities not included)	Union acting in non-union supervisory role: minimum 5% Non-union: 5-10% increase	Nothing in lieu of overtime	Managed in the same manner as supervisor differentials	Car allowance for manager-level
Company F	15% with an OT assumption; 25% without	$1,000 /month (1 month to qualify; retroactively paid if not planned)	Nothing in lieu of overtime	Maintain 15% differential; managers also eligible for larger incentive	Change supervisor workweek to 4x10hrs to better match subordinates; supervisors now travel direct between home-site
Nalcor	20% (no OT included)	5% per grade (max 10%); halved if performing partial duty; no time requirement	2x when required to be on-site supervising; no OT for those above supervisor level	Yes, compression issue extends to managers	
MTCS Survey Respondents	Median differential of 10% (66% assume average overtime for highest paid subordinate)	90% have acting up policy; 56% of these have minimum time period ranging from less than 1 week to 90 days 38% add a percentage (average of 8%)	Field supervisors at 78% of respondents are eligible for OT	n/a	

Summary of Findings and Recommendations

Head Office, Bull Arm, Churchill,

Summary of Findings and Recommendations – Head Office, Bull Arm, Churchill, Hydro and Lower Churchill Divisions Overview

- Given that the majority of Nalcor's business units and operations are aligned with the utilities industry, the most relevant market data for head office employees is utilities data
- Operations in the Churchill, Lower Churchill and Hydro divisions are also primarily utilities
- While operations in Bull Arm are not specifically aligned with the utilities industry, many of the senior employees (i.e., grades Hay-10 and above) are transfers from the other utilities-related divisions
- For job grades Hay-01 to Hay-09, positions will not typically require a significant amount of utilities specialization, so the proposed salary structure was based on comparisons to general industry
  - For positions where employees may reasonably be recruited from within Atlantic Canada, we made comparisons to both Atlantic and Canada-wide general industry data
  - The proposed salary grades for Hay-01 to Hay-09 are very similar to the current salary grades
  - For the salary grades Hay-05 to Hay-09 (note that Hay-01 to Hay-04 are not in use):
    - The proposed range midpoints are 5% to 7% below the current range maximums and the proposed range maximums are 3% to 5% above the current range maximums
  - The market data does not support providing short-term or long-term incentives at these levels

Summary of Findings and Recommendations – Head Office, Bull Arm, Churchill, Hydro and Lower Churchill Divisions Overview (cont'd)

- For job grades Hay-10 to Hay-18, utilities-specific skill sets will be more typically required, so the salary structure and proposed incentive ranges were based on comparisons to the utilities sector
  - We are proposing increasing the spread between the range minimums and maximums to approximately 40% to facilitate salary administration within the range
  - The proposed range midpoints are 7% to 22% above the current range maximums and the proposed range maximums are 25% to 43% above the current range maximums
  - Proposed short-term incentives vary from 0% to 20%
  - The market data does not support providing long-term incentives to these divisions
- Note that Nalcor should consider providing additional compensation to employees working in remote locations
  - Remote location compensation practices may need to be researched to establish such a policy
- Note that we have applied geographic differentials to national and Alberta-based data for positions with market median salaries below $120,000 to estimate Atlantic Canadian data

Summary of Findings and Recommendations – Head Office, Bull Arm, Churchill, Hydro and Lower Churchill Divisions Proposed Structure & Incentives

- We suggest the following compensation structure for the utilities focused divisions:

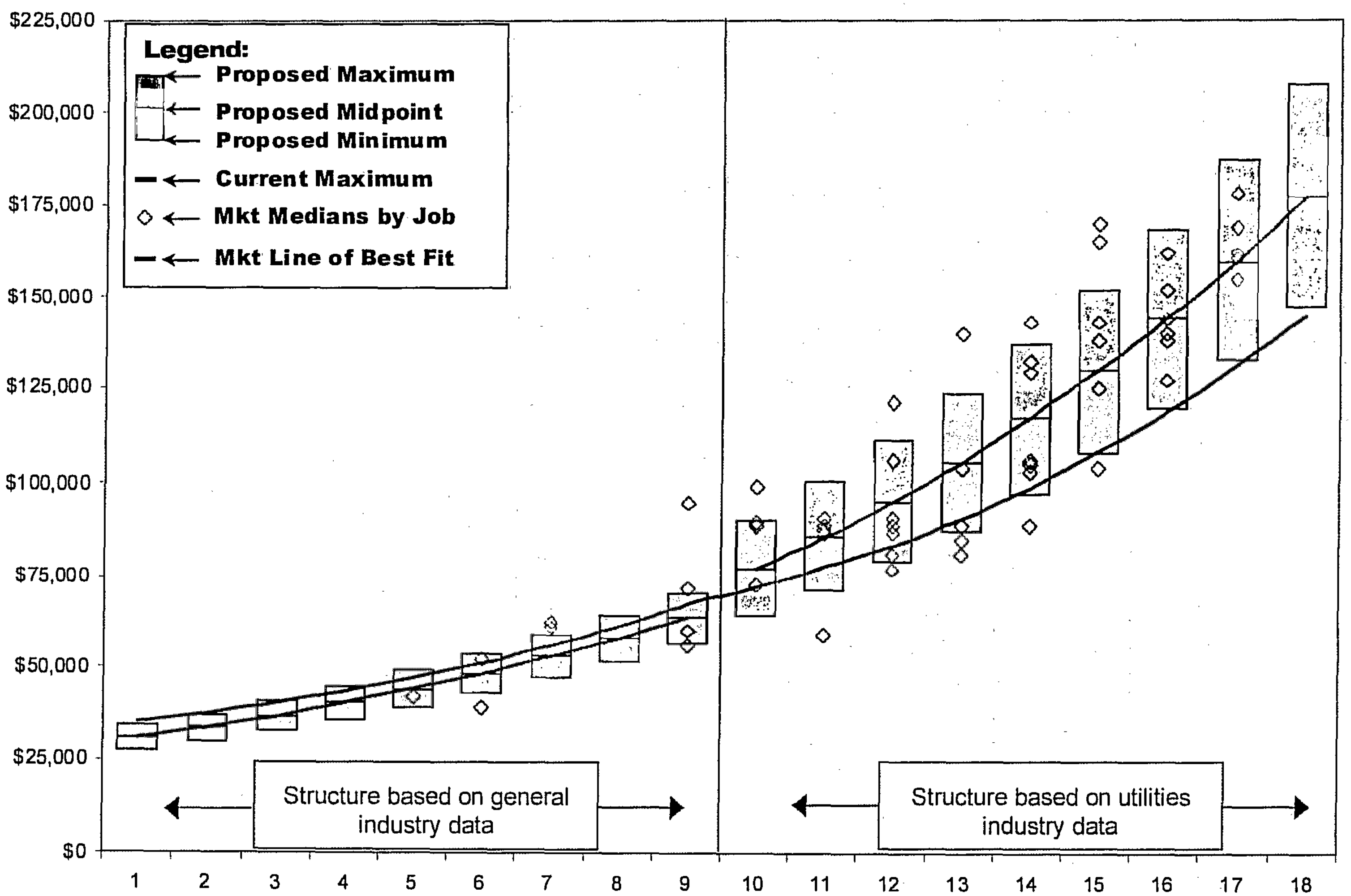
Pay Grade	Current Grade Maximum	Proposed Salary Grades			Proposed Incentives	
		Minimum	Midpoint	Maximum	Target STI	Target LTI
Hay-01	35,200	27,100	30,500	33,900	0%	0%
Hay-02	37,650	29,700	33,400	37,100	0%	0%
Hay-03	40,250	32,500	36,600	40,700	0%	0%
Hay-04	43,400	35,700	40,200	44,700	0%	0%
Hay-05	47,050	39,100	44,000	48,900	0%	0%
Hay-06	50,950	42,800	48,200	53,600	0%	0%
Hay-07	55,900	47,000	52,900	58,800	0%	0%
Hay-08	61,300	51,600	58,000	64,400	0%	0%
Hay-09	67,500	56,500	63,500	70,500	0%	0%
Hay-10	72,300	64,200	77,400	90,600	0%	0%
Hay-11	77,550	71,200	85,800	100,400	0%	0%
Hay-12	83,650	79,000	95,200	111,400	0%	0%
Hay-13	90,650	87,600	105,600	123,600	10%	0%
Hay-14	98,750	97,200	117,100	137,000	15%	0%
Hay-15	108,150	107,800	129,900	152,000	15%	0%
Hay-16	118,600	119,600	144,100	168,600	20%	0%
Hay-17	131,000	132,600	159,800	187,000	20%	0%
Hay-18	144,950	147,200	177,300	207,400	20%	0%

(1) For all levels, current target STI is 6%, current maximum STI is 9%

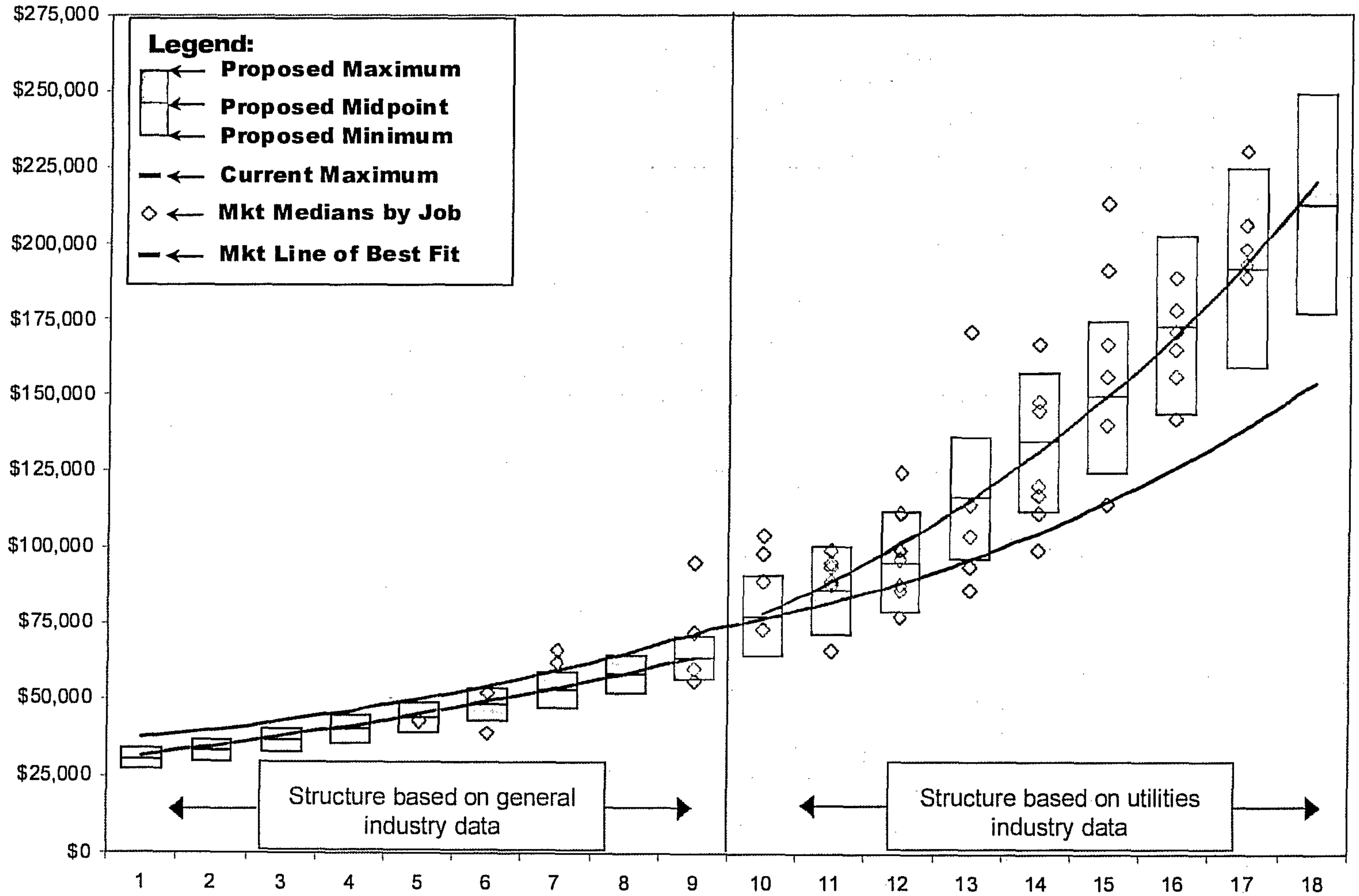
(2) LTI is not currently offered to any employees

- The competitiveness of this structure is shown on the next 3 slides, covering: base salary, total cash compensation and total direct compensation, respectively
- Note that while this structure is generally competitive with the market, there are a number of positions that will not be paid competitively
  - Nalcor may wish to assess whether all of these positions are evaluated appropriately or need to administered in a different level
- Grades Hay-14 and below reflect rates adjusted for Atlantic Canada

Summary of Findings and Recommendations – Head Office, Bull Arm, Churchill, Hydro and Lower Churchill Divisions Base Salary



Summary of Findings and Recommendations – Head Office, Bull Arm, Churchill, Hydro and Lower Churchill Divisions Total Cash Compensation



Summary of Findings and Recommendations – Head Office, Bull Arm, Churchill, Hydro and Lower Churchill Divisions Total Direct Compensation