NP 2016/2017 General Rate Application
Information - #9
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BRITISH COLUMBIA UTILITIES COMMISSION

IN THE MATTER OF

FORTISBC INC.

MULTI-YEAR PERFORMANCE BASED RATEMAKING PLAN FOR 2014 THROUGH 2018

DECISION

September 15, 2014

Before:

D.A. Cote, Panel Chair/Commissioner
N.E. MacMurchy, Commissioner
D.M. Morton, Commissioner

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3.1.2.3 Executive Compensation Study and Short-Term Incentive Plan

In the FBC 2012–2013 RRA Decision, the Commission was of the view that FBC's compensation package should be reviewed in its entirety before a determination could be made as to whether it was appropriate. The Commission directed FBC to provide benchmarking information on all elements of its executive compensation in its next RRA.

In this Application, FBC submitted a May 2013 Executive Compensation Review conducted by Hay Group Limited (Hay) on a confidential basis. Subsequently, a redacted version of this review was submitted in response to BCUC IR 1.221.1.1. FBC engaged Hay, its primary compensation consultant, to provide comparative analyses of market compensation data reflecting the pay levels and practices of more than 250 Canadian Commercial Industrial Companies. The Hay study looked specifically at "*Total Direct Compensation*" which is comprised of base salary, short-term incentives, and long-term incentives. (FBC Exhibit B-7, Attachment 226.1.1, Executive Compensation Benchmarking Study)

The following summarizes the observations from Hay's Executive Compensation Review:

- FBC's target *Total Direct Compensation* is below market median for all roles; however, actual *Total Direct Compensation* is somewhat moderated by the strong actual short-term incentive payouts, which ultimately position most FBC executives close to the market median;
- FBC's executive base salaries are generally positioned around the market median, and the target total is close to median for most roles;
- Actual total cash compensation (excluding long term incentives) is very competitive, with all roles above market median.

(FBC Exhibit B-7, Attachment 226.1.1, Executive Compensation Benchmarking Study, pp. 8–11)

In its study, the Hay Group used its comparable Canadian Commercial Industrial reference group which consisted of 275 different companies. When questioned about the appropriateness of the broad-based comparator group included in the study, FBC stated that this group is appropriate for the following reasons:

- There exists a broad spectrum of commercial and industrial organizations with which FBC competes for executive talent;
- A larger comparator group leads to more stable data year over year;
- These organizations represent a stable, national comparator upon which to base compensation policy.

(Exhibit B-7, BCUC 1.219.1.1)

FBC also filed its 2013 Short-Term Incentive Plan (STIP) targets and explains that there are both corporate and personal objectives to be obtained before STI's are granted. Table 3.5 shows FBC's 2013 corporate targets and weightings:

Table 3.5 FBC's 2013 Corporate Targets and Weightings by Category

The targets and weightings for 2013 are:

			2013 Targets			
Category	**Measurement**	**2012 Results**	**Minimum 50%**	**Target 100%**	**Maximum 150%**	**Weight**
Financial	Regulated Earnings	$48.5	Plan -2% $43.2M	Plan $44.1M	Plan +2% $45.0M	30%
Safety	All Injury Frequency Rate (AIFR)	1.72	Target +10% 1.80	Average of last 3 years 1.64	Target -10% 1.48	10%
	Recordable Vehicle Incidents	22	Target +10% 30	Average of last 3 years 27	Target - 10% 24	10%
Customer	Customer Service Index (CSI)	8.4	8.3	8.5	8.7	12.5%
	System Average Interruption Duration Index (SAIDI)	1.95	Target +5% 2.33	Average of last 3 years 2.22	Target -5% 2.11	12.5%
Regulatory	Regulatory Performance	-	Subjective	Subjective	Subjective	25%
TOTAL						100%

(Source: Exhibit B-7, Attachment 221.1)

FBC explains that the STIP is based on corporate and individual performance objectives and that the corporate objectives have four components: Financial, Safety, Customer and Regulatory. Each component has three measures: threshold (50 percent), target (100 percent) and maximum (150 percent) and the benefits are allocated as follows:

- If performance is below target, the variance from target is prorated between threshold (50 percent) and target (100 percent);

- If performance is above target; the variance is pro-rated between (100 percent) and maximum (150 percent).

The target payout levels and the design of the weightings for the purpose of determining payouts are:

	Weightings		
Position	Individual	Corporate	Target Bonus Level (% of Salary)
President and CEO	20%	80%	50%
Vice Presidents	50%	50%	30 - 40%

(Source: Exhibit B-7, Attachment 221.1)

With respect to the competitiveness of the STIP, the Hay Group makes the following comments:

- Actual total cash [Base Salary + Actual STI] is very competitive, with all FortisBC executives above market median. This is driven by strong actual STI grants as compared to the market, with all actual STIs above the 70th percentile.
- The strong STI rewards driving competitive total cash are largely offset by weak long-term incentive (LTI) compensation, resulting in actual total direct compensation [Actual Total Cash + LTI] generally around market median.

(Exhibit B-7, Attachment 226.1.1)

Table 3.6 provides a review of STI payments as a percentage of salary from a historical perspective.

Table 3.6 Short-Term Incentive Payments to FBC Executives for the Last Five Years

	Actual STI as % of Salary				
	2008	2009	2010	2011	2012
President & CEO	56.94%	60.00%	79.08%	85.00%	76.92%
EVP HR, Customer and Corporate Services	41.86%	45.65%	56.96%	67.62%	60.34%
EVP Network Services, Engineering and Generation	41.86%	45.65%	43.48%	65.74%	60.49%
VP Finance & CEO	44.19%	45.65%	52.17%	63.83%	68.02%
VP Operations Support, Gen Counsel & Corporate Services	49.50%	46.67%	48.00%	54.16%	50.74%
VP Resource Planning	38.64%	45.65%	50.00%	-	-
VP Energy Solutions & External Relations	-	-	46.95%	63.50%	58.94%
VP Energy Supply & Resource Development	-	-	46.36%	59.76%	68.97%
VP Strat Plan, Corporate Development and Regulatory Affairs	-	-	62.79%	63.83%	68.02%
VP Customer Service	-	-	-	-	46.48%

(Source: Exhibit B-7, BCUC 1.221.1.2)

A review of this table shows that there has likely been an increase in STIP in the 2011/2012 years as compared to 2008 or 2009.

Commission Determination

FBC's long-term incentive amounts (i.e. stock options and PSUs) are not recovered from the ratepayer and the Company has provided limited information on this component. Because of this, the Commission Panel focuses on the short-term incentives as a percentage of base salary and total cash compensation.

The three main areas of concern to the Panel are:

- Whether the Hay study comparator group is reasonable;
- Whether the STIP targets will provide benefits to the ratepayers; and
- Whether short-term incentive amounts paid to executives are reasonable.

Hay Study Comparator Group

The Commission Panel accepts that FBC competes for executive talent in the broad spectrum of commercial and industrial organizations. Therefore, FBC's rationale for the choice of the larger, broad-based comparator group is reasonable.

Provision of Benefits to Ratepayers

The Panel has concerns as to whether all of the components of FBC's corporate and individual performance objectives or scorecard provide value to the ratepayer. The Panel notes that the corporate financial objective with the highest weighting, at 30 percent, is regulated earnings. While there is no disagreement as to the importance of a utility being healthy and financially sound financially, the Panel is not persuaded that exceeding its approved ROE is in the interest of ratepayers.

For these reasons, the Panel is not persuaded there is sufficient evidence to support the need for the STIP to be fully funded by the ratepayer. **The Commission Panel finds that 30 percent of the STIP costs are on the account of the shareholder. Therefore, the Panel directs FBC to recover only 70 percent of the STIP from the ratepayer and reduce its O&M Base accordingly.**

Reasonableness of STI Paid to Executives

The evidence regarding executive total direct compensation indicates that the actual STIP is very competitive when compared to the market median. This is confirmed by the Hay Study which states that weakness or shortfall in the competitiveness of long-term compensation is somewhat moderated by the strong actual short-term incentive payouts (Exhibit B-7, Attachment 226.1.1, p. 8). Of concern to the Commission Panel is the extent to which actual Total Cash paid to executives for base salary and STI exceeds the target or median Total Cash paid as indicated in the confidential report (Exhibit B-1-1, Appendix C 2). As noted previously in Section 3.1.2.2, FBC has stated that its approach to total compensation is to be in the median level in its peer group. The Panel accepts this. However, if there is a shortfall in the amount of executive compensation as pointed out by the Hay Group, it is with the long-term elements of the plan, not the STI. In the Panel's judgment it is not reasonable to offset any shortfall in long-term incentives of the executive compensation plan by increasing the STI to a level that is well above target. **Therefore, the Commission Panel finds that the STI costs as they relate to the ratepayer are to be restricted to the target (as outlined in the Hay Report) STI compensation only. The Panel understands that this equates to the target median within its comparative peer group and directs any amounts in excess of the target median to be borne by the shareholder.**

In summary, FBC is to calculate the STIP payment based on the target median and then deduct 30 percent of this calculation to arrive at the amount to be borne by the ratepayer. Any STIP amounts paid in addition to this are to be borne by the shareholder.

As part of its Compliance Filing, FBC is directed to provide the following information for 2013: (i) the amounts spent on the Executive STI, and (ii) the amount that would have been spent if only the target STI had been met (as per page 9 of the Executive Compensation Benchmarking, Exhibit