

Paper to : **TEL Remuneration Committee**
Subject : **Annual Bonuses at tie for 2009/10**
Date : **June 2010**

Purpose of this Paper

In September 2009 the Remuneration Committee (RemCo) approved two new bonus schemes for tie. One scheme is based purely on project completion; the other has both an annual and a project completion element.

This paper is to consider only the annual element for 2009/2010. The annual element is based on an assessment of the company's performance at financial year end (April) and requires that, at the first suitable meeting following the end of the financial year the Committee considers the company's performance and the implications for bonus payments in line with the policy.

We now have sufficient information to inform a recommendation to the Committee for consideration.

Summary of the schemes

The approach was approved by the RemCo in September 2009. In summary it consists of two levels;

The Senior Director's (or Deferred) scheme, which only pays a bonus upon project completion against the achievement of certain targets. There is no annual bonus for the senior directors, so there is nothing to consider for this group in this paper. This is currently only applicable to the eight senior directors of tie.

and

The General Scheme, which has both an annual and a project completion element. The annual element of bonus payable is based on the Annual Corporate Performance Score (ACPS%), multiplied by the individual's Personal Performance Score (PPS%), multiplied by their bonus entitlement (currently 15%), multiplied by their annual salary.

The project completion element allows employees to earn up to an additional 10% at project completion, and is consequently not up for review at this time.

Targets

Both schemes are based on targets of cost, programme and a basket of KPIs, detailed in appendices 1 & 2 to this paper.

The senior director's scheme is explicit that if cost or programme targets are not met, then no bonus is payable. The general scheme does not explicitly state this for the annual element, and is therefore left to the discretion of the Remuneration committee.

Assessment of performance

Cost

It is now highly unlikely that the whole scope of the project can be achieved within the original funding envelope of £545m. Indeed, given the uncertainty of the current situation, it is also not certain that the whole scope can be delivered within the £600m outer target at which the score for this element of the bonus falls to zero. The assessment of the executive team is therefore that this element of the bonus is zero

Time

As with the cost, the current disputes make the prediction of any completion date for the whole scope of work very difficult. The current best estimate is that the whole scheme could be completed by the end of 2012, which would give rise to a score of approximately 16%, although this is subjective and depends on the resolution of the current disputes with the contractor.

KPI

Appendix 3 shows the management team's assessment of the performance of the business against the basket of KPIs, and gives a combined score of 72.5%. Details of this assessment will be presented for discussion at the meeting if required.

Bonus Calculation

Applying the weighting to each of these gives the components of the ACPS as

Cost	$0\% \times 35\% = 0\%$
Time	$16\% \times 35\% = 5.6\%$
KPI	$72.5\% \times 30\% = 21.75\%$

The calculation of the ACPS would be the sum of the above, 27.35%.

However, as the cost element of the bonus is now evaluated as 0% it falls to the discretion of the Remco as to whether the ACPS is also therefore 0%.

Recommendation

In coming to a conclusion as to what recommendation to make to the RemCo, the Executive Committee, led by the CEO, has considered the context in which any bonus payment will be paid. It should be stressed that, the policy is the policy, and where payments are contractually due, then the recommendation would always be that they should be paid, irrespective of the context. However, given the underlying performance of the business against the agreed targets, then it is clear that discretion is required. In exercising this discretion, it is right that this is done (and deliberations recorded) with regard to a number of factors, and not done in an arbitrary fashion. In particular, attention was given to;

- Project predicament – the current uncertainty over cost, programme, progress and contractual disputes.
- Performance of the business against the KPIs, in a particularly difficult trading environment.
- External factors - such as the general economic climate, the media and political climate and the views of shareholders.
- Annual pay rise - there was no annual pay rise at tie this year
- Staff morale - there are some signs of staff feeling the pressure of the current situation. However staff understand the pressures on the business and the project predicament. The lack of a pay rise was received as well as could be expected, and expectations of a bonus are low. There is some suspicion that the bonus scheme was changed during the year to make the prospect of bonuses much more remote, and that this is all part of an attack on terms and conditions. However, the biggest factor affecting staff morale is the lack of physical progress on the project.
- Staff retention, there is no sign of valued staff members leaving the business, and no sign that our total remuneration package is becoming un-competitive
- Other internal factors – we have recently made several staff members redundant.

Having taken into account the above factors, and the views of the Executive Committee, the recommendation of the CEO is that the ACPS is set at 0% and therefore no bonus is payable this year. Furthermore that the targets for the project are reset once the outcome of project Carlisle and/or project notice are known. This re-setting of the targets will then apply to both the current financial year and the project overall, it will also require the re-setting of the ‘start date’ from which any bonus entitlement begins to 1st April 2010, in effect, no element of 2009/2010 salary will count towards the project completion bonus.

Questions

The decisions for the Remco are;

- Does the Remco agree with the scoring proposed by the Exec team, accepting that there is subjectivity included, especially in relation to the date?
- Given the cost score is 0%, does the Remco believe it is right to set the Annual corporate performance Score to 0%?
- Having considered matters for themselves, and the relevant factors, does the Remco endorse the recommendation of the CEO that there should be no bonus this year?
- Does the Remco endorse the recommendation of the CEO that going forward targets should be reset once the outcome of project Carlisle/project Notice is known (this avoiding a ‘double penalty’ situation, whereby no bonus ever becomes achievable), and that the relevant ‘start date’ for bonus calculation is re-set as 1st April 2010?

Appendix 1

Bonus payout compared to achievement of targets

Cost (35% weighting)

£545m pays 100%

£575m pays 75%

£600m pays 0%

Intermediate figures calculate on a linear basis

Date (35% weighting)

Feb 2012 pays 100%

May 2012 pays 75%

Aug 2012 pays 50%

Nov 2012 pays 25%

Feb 2013 pays 0%

Intermediate dates calculate on a linear basis

Appendix 2 KPIs

Performance against each KPI will be assessed taking into account the measures set out against each KPI. For the annual assessment of performance against KPIs judgement will have to be used to establish progress/performance. At project completion the assessment will be based on actual performance against the board's expectations.

The KPI's below are draft only and are subject to agreement with the Board.

Safety KPI	Measurement
Deliver the tram safely	<p>There have been zero project fatalities and zero serious injuries with any degree of tie implication or lack of possible prevention or expected intervention. We have demonstrated improvement in our H&S performance during the project in the following areas</p> <p>Morale – Our Accident Frequency Rate is better than industry average Financial – We received no substantial claims or damages as a result of H&S incidents</p> <p>Legal – tie have not been prosecuted We are progressively demonstrating improvement against the deliver the tram safely strategy and the Annual Safety Plan targets:</p> <ul style="list-style-type: none"> • Improvement in the number uninjured workers and members of the public • Minimising the financial value of claims and damages to services • Successful engagement and interface with the Regulatory bodies including no enforcement action.
Deliver a safe tram	<p>A “No Objection” to operate the Tram was given by the ICP (and/or) There are no temporary speed restrictions as a result of inadequate design or construction</p> <p>We are progressively demonstrating improvement against the deliver a safe tram strategy:</p> <ul style="list-style-type: none"> • Design is to an acceptable standard • Construction is to an acceptable design and quality • The ICP is engaged/ No major RFI's outstanding

Stakeholder Support	Measurement
Brand: Promote the tram, generating pride and excitement.	Any public opinion survey that may be available Broadcast the brand in all activity
Customer services: Handle all complaints in a professional manner, respond in an appropriate timeframe with open and honest information.	Measure the number and type of complaints that are received. Measure response times
Stakeholders: Keep our stakeholders well informed with up to date and accurate information.	Feedback from stakeholder groups and individuals Visible, co-operative working relationships Feedback from politicians
Media: Implement an ongoing news bank of information providing proactive news stories	Press Coverage, quantity of coverage and positive to negative article ratio. Up to date news bank of information

Operational Readiness	Measurement
Are plans in place and are they being delivered against	Plans for preparing for the tram are being progressed
Are staffing structures in place and is recruitment up to speed	Organisation designed and clearly thought through with organisation design principles set from the start. Terms and conditions thoroughly researched into before recruitment begins. Appropriate recruitment process designed to attract the right candidates.
Are health and safety issues properly covered	Health and safety procedures for tram operating in place.
Relationship with Lothian Buses	Integration of the buses and trams investigated and maximised. Integrated ticketing successful.
Successful opening day/first week/ first month	Public opinion surveys

Team Culture	Measurement
Develop the OEM	<p>Values for staff developed and visible in the organisation.</p> <p>Vision, objectives and strategies are widely communicated including to new starters and reviewed regularly.</p>
Performance Management	<p>All employees have a mid-year review and final appraisal</p> <p>Developmental discussions have taken place</p> <p>Objectives set within the month after financial year end for every employee. A stronger focus on performance management within tie.</p>
Leadership Development	<p>Leaders are assessed regularly on their performance against the values.</p> <p>The values are embedded in everything they do.</p> <p>Personal profiles for every employee.</p>

Appendix 3, management assessment of performance against KPI

Safety 75%

Operational readiness 75%

Stakeholder support 90%

Team culture 50%

Average 72.5%