

Briefing Note

# Rail Safety and Executive Compensation in the TSX60



PHOTO: U.S. FEDERAL RAILROAD ADMINISTRATION

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Shareholder Association  
for Research & Education  
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**A**lmost one year ago the community of Lac Megantic, Quebec faced a horrible and preventable tragedy when a train derailment and explosion killed 47 people. It was a reminder of the horrific consequences that can result from poor safety management and lack of effective regulatory oversight, especially when dangerous goods such as light crude oil are being transported through communities.

It is appropriate, one year later, to ask whether railways and shippers of dangerous goods by rail have taken on board the lessons of Lac Megantic and what position safety management occupies in the company's overall mindset.

One way to measure how much a company values a particular operational priority is whether the company's Board of Directors has established effective oversight of the issue and whether they include it in their evaluation of executive performance.

This briefing note looks at the railways and shippers of dangerous goods by rail (e.g. oil and gas) that are part of the TSX 60 index to determine, one year after Lac Megantic, whether they have formal board oversight of occupational health and safety (OHS) in place and whether they have included OHS in their formal evaluation of executive performance – and therefore executive compensation.

## Methodology

SHARE's staff reviewed the most recent Management Information Circulars from seventeen companies on the TSX60 to identify those that had a Board-level health and safety committee, and those that explicitly included health and safety issues in the performance evaluation of Named Executive Officers (NEOs). The seventeen companies include the two rail transport companies and the major energy companies in the TSX60 that ship by rail. Two energy companies were subsequently excluded from the study because they do not ship goods by rail.

SHARE evaluated the remaining fifteen companies on the following, based on public disclosures:

- Whether the Board had a committee dedicated to reviewing health and safety policy and performance;
- Whether the CEO is evaluated in any fashion based on safety performance
- Whether other NEOs are evaluated in any fashion based on safety performance
- Whether the company publishes specific targets for safety performance
- Whether the company indicates any weighting for safety performance measures vs other measures

In addition, the most recent Management Discussion and Analysis (MD&A), Annual Information Forms, and Annual Reports from each of the energy companies (railways excluded) was reviewed to determine whether the company identifies rail transportation of oil by rail as a material risk, including:

- the possibility of delays to market;
- regulatory risk; or
- legal liability for accidents

## SHARE's Investor Guidance on Occupational Health and Safety

Poor management of OHS has impacts not only on the well-being of workers and their families but for a company's bottom line as well, including increased workers' compensation premiums, decreased productivity, absenteeism, higher healthcare costs, potential lawsuits, negative publicity, and a loss of investor and consumer trust.<sup>1</sup> As such, measurements of health and safety performance are among the most widely-used indicators by investors assessing the human and labour rights performance of companies and are widely-accepted as relevant indicators when evaluating management's investments in human capital.<sup>2</sup>

SHARE's *Investing in Decent Work* program has identified OHS as a priority for its clients, alongside other decent work issues such as child and forced labour and precarious work (for more information, see [www.decentwork.ca](http://www.decentwork.ca)). As part of that program, SHARE has developed a set of best practice principles for Canadian companies to move beyond basic legal and regulatory compliance of OHS to implement a comprehensive framework to protect and promote worker health and safety. SHARE's *Investor Guidance on Occupational Health and Safety in Canada*<sup>3</sup> helps investors assess how well a company is managing OHS throughout their operations.

<sup>1</sup> See Burton, Joan. *The Business Case for a Healthy Workplace*, IAPA, 2008. Available at:

[http://www.iapa.ca/pdf/fd\\_business\\_case\\_healthy\\_workplace.pdf](http://www.iapa.ca/pdf/fd_business_case_healthy_workplace.pdf)

<sup>2</sup> See Soyka, Peter A. and Bateman, Mark E. *Finding Common Ground on the Metrics that Matter*. IRRC, 2012. p.36. Available at: [http://www.irrcinstitute.org/pdf/IRRC-Metrics-that-Matter-Report\\_Feb-2012.pdf](http://www.irrcinstitute.org/pdf/IRRC-Metrics-that-Matter-Report_Feb-2012.pdf)

<sup>3</sup> Available for free download at: [http://www.share.ca/files/12-4-27\\_Investor\\_Guidance\\_on\\_OHS\\_-\\_Final.pdf](http://www.share.ca/files/12-4-27_Investor_Guidance_on_OHS_-_Final.pdf)

## Board oversight of health and safety

100%

Many corporate boards of directors, especially in traditional manufacturing or industrial sectors, have functioning health and safety committees that oversee policy and strategy on health and safety. All of the companies we surveyed had active board-level committees responsible for health and safety oversight.

A board-level committee responsible for OHS better ensures a long-term and sustainable focus on improving workplace health and safety. To be most effective, a board OHS committee should have a majority of independent members and be supported by accurate and relevant performance monitoring information and adequate resources. Board members serving on the committee must be competent in OHS issues and motivated to establish a strong OHS culture within the company.

## Identifying risks

46%

Of the energy companies we surveyed, just under half identified rail transportation as a possible material risk factor for the company.

As an example of the kind of language that might be included in company disclosures regarding the risks associated with oil-by-rail shipments, Cenovus includes this in their Annual Information Form:

*Our product or railcars may be involved in a derailment or incident that results in legal liability or reputational harm. In addition, if new regulation is introduced, including but not limited to the potential amendment of the safety standards for tank cars used to transport crude oil, it could adversely affect our ability to ship crude oil by rail or the economics associated with rail transportation.*<sup>4</sup>

<sup>4</sup> Cenovus. Annual Information Form for year ended December 31, 2013. Page 52

Identification of safety risks as material for the company helps to ensure that resources are dedicated to effectively managing those risks.

### Executive performance measurement and compensation

Although board-level committees are more common, fewer corporate boards of directors have established health and safety targets for executive management, or included health and safety indicators in their formal evaluation of executive performance when establishing annual executive pay.

Shareholders expect clear disclosure from the board concerning the structure, measurement, and amount of executive compensation packages and the advent of “say on pay” votes at an increasing number of Canadian publicly traded companies has created a new incentive to describe clearly how executive management is rewarded. Disclosure should include descriptions of the goals, indicators and targets used to assess executive performance, how they are weighted, and how they are linked to specific types and levels of compensation.

SHARE’s *Model Proxy Voting Guidelines for 2014* state that goals and targets for performance-based executive compensation should be established at the beginning of the evaluation period, should be within the control or influence of the employee being evaluated, and should focus on the company’s profitability in the long term. For this reason, SHARE encourages performance goals that contribute to long-term value such as customer satisfaction, product quality, employee development, and the company’s environmental, health and safety record.

SHARE does not have specific guidelines for *how* OHS should be included in executive performance evaluations, since the specific goals and indicators may differ by sector and company. Importantly, any goals and indicators used should not encourage under-reporting of safety incidents or otherwise stifle open communication of risks within the company. Instead, companies should use leading safety indicators that measure safety culture, training and employee understanding and satisfaction, but do not carry the risks of under-reporting.

80%

Within the fifteen TSX60 companies SHARE evaluated, twelve **included some type of safety metric** amongst the factors the compensation committee uses in evaluating the CEO’s annual performance. A smaller number (nine) explicitly included safety amongst the factors used to evaluate other NEOs.

40%

Unfortunately, the **specific metrics** used to evaluate safety performance are only identified by six companies (40%) and no company identifies the **actual targets** executives are expected to meet to earn their bonuses. Some companies, such as CN Rail, have identified safety targets for their general operations – which is positive – but these are not explicitly linked to executive performance evaluations.

47%

Lastly, only seven of the companies include some information on **how these factors are weighted** in the overall evaluation of executive bonuses. Even among those that do disclose how factors are weighted, safety metrics are often bundled with other performance metrics that are then given a single overall weight. There is room for much stronger disclosure in this area.

## Conclusion

The Lac Megantic disaster was a terrible tragedy for the community in which it took place, and a strong example of why effective management of health and safety practices must be a primary responsibility for any company's managers.

One year after that tragedy, we would have expected to see universal acknowledgement amongst the companies shipping potentially volatile products by rail that there are risks that need to be managed for the health of those communities and the company itself. Integrating safety metrics into the evaluation of executive performance is one way to provide

incentives for better safety management, and implicitly recognizes that the executive's approach to managing safety in the company's operations can impact long-term value for shareholders and the communities in which it operates.

The good news is that more than three-quarters of the companies surveyed are including some type of safety measurements in their evaluation of executive performance, but there is still room for improvement. For shareholders to know what risks are being prioritized and how strong the incentives are for management to address them, more extensive disclosure of compensation practices is in order.



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## Appendix A: Company results

Ticker	Company	Cttee on OHS	CEO	Other NEOs	Specific metrics	specific targets	Weighting disclosed?	Material risk identified?
ARX	ARC Resources Ltd.	✓	✗	✗	✗	✗	✗	✓
CNR	Canadian National Railways	✓	✓	✓	✗	✗	✗	N/A
CNQ	Canadian Natural Resources Limited	✓	✓	✓	✓	✗	✓	✗
COS	Canadian Oil Sands Limited	✓	✗	✗	✗	✗	✗	✗
CP	Canadian Pacific Railways	✓	✓	✓	✗	✗	✗	N/A
CVE	Cenovus Energy Inc.	✓	✓	✓	✗	✗	✓	✓
CPG	Crescent Point Energy Corp.	✓	✓	✓	✗	✗	✓	✓
ENB	Enbridge Inc.	✓	✓	✓	✓	✗	✓	✗
ECA	Encana Corporation	✓	✓	✓	✓	✗	✓	✗
ERF	Enerplus Corporation	✓	✓	✓	✓	✗	✓	✓
HSE	Husky Energy Inc.	✓	✓	✗	✓	✗	✗	✓
IMO	Imperial Oil Limited	✓	✓	✗	✗	✗	✗	✗
MX	Methanex	✓	✓	✗	✗	✗	✗	✗
PWT	Penn West Petroleum Ltd.	✓	✗	✗	✗	✗	✗	✓
SU	Suncor Energy Inc.	✓	✓	✓	✓	✗	✓	✗
TOTAL NUMBER		15	12	9	6	0	7	6
TOTAL PERCENTAGE		100%	80%	60%	40%	0%	47%	46%