reo® viewpoint

Matthias Beer, Analyst, Governance and Sustainable Investment

February 2012

Cairn Energy withdraws resolution on bonus for Chairman

The UK oil and gas company, Cairn Energy plc, announced last week that it intends to withdraw a resolution relating to a share award worth £2.5 million for its Chairman and former CEO, Sir Bill Gammel, from consideration at the General Meeting on 30 January 2012. This withdrawal came following criticism from institutional shareholders, F&C among them, working in collaboration through representative bodies.

Cairn originally proposed this award to recognise Sir Bill's instrumental role in delivering a major transaction of Cairn's stake in its former Indian business arm, Cairn India Ltd., with India-based mining company Vedanta Resources plc. The transaction raised USD 5.5 billion for the company, of which USD 3.5 billion will be returned to shareholders following approval at this year's General Meeting.

While F&C recognises Sir Bill's record of generating shareholder value, as well as the substantial cash return in relation to the Vedanta deal, F&C expressed its concern that a special 'transaction bonus' to ensure the successful completion of this deal was not sufficiently warranted in light of his overall comprehensive incentive arrangements. These include sharing in the cash return through his direct holdings of Cairn shares, potential benefits accruing from outstanding share incentive awards and the termination payment following the end of his tenure as CEO. We also consider the structure of the proposed share award to be problematic, in particular the fact that the vesting would not have been dependent on the Chairman remaining as a Director of Cairn over the three year holding period of the award. In light of these concerns we welcome Cairn's decision to withdraw the resolution and to engage in further consultation with shareholders to resolve this matter.

This development takes place in the broader context of increasing investor scrutiny of executive remuneration in the UK, where F&C and other investors are seeking to hold boards and remuneration committees to greater account, to ensure an appropriate balance between executive pay and performance.

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Elizabeth McGeveran, Senior Vice President

February 2012

Investor logic wins through at Nabors

Securing a retirement nest-egg is the aim of all pensioners – but a hundred million dollar payoff is unusual by any standards, particularly for the head of an underperforming company. After a prolonged battle, investors have persuaded Eugene Isenberg, departing CEO and Chairman of oil services company Nabors, to give up his nine-digit severance pay.

No need to feel too bad for Mr Isenberg. He's made that amount in pay in the past three years, during a time when Nabors' share price has barely kept pace with the S&P 500, and rivals like Patterson-UTI and Helmerich & Payne have enjoyed stellar gains. To put the $100 million in context, it was more than the company's 2010 annual net profit of $95 million - justifying shareholders' feeling that the company was being plundered in broad daylight.

This has been a long war of attrition for investors. Isenberg had secured a highly lucrative pay package after leading the company out of bankruptcy in the late 1980s. F&C's engagement with the company dates back to 2007, when we first raised concerns about excessive executive pay that had far outstripped peer companies. We encouraged the board to change its pay structure, which had rewarded top executives with a percentage of cash flow, rather than setting more challenging and meaningful performance measures. The board told F&C in 2008 that it was actively looking into changing compensation plans. We were also actively involved in attempting to persuade Nabors to put its executive pay package to an annual advisory shareholder vote. Years of frustration came to a head in December when five major US public pension funds demanded to nominate a director of their own and the SEC started an inquiry into executive perks, finally resulting in the climbdown by Isenberg.

The Nabors experience serves as a cautionary tale for other companies with pay plans that are out of line with company performance: shareholders are losing patience, and are increasingly willing to use their clout to rein in unjustified excesses.

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reo® viewpoint

Yo Takatsuki, Senior Analyst February 2012

Olympus reforms fall disappointingly short

Hopes that the revelation of a $1.5 billion accounting scandal at Olympus would pave the way for major reform in Japanese corporate governance suffered a major setback when the company unveiled its new proposed board on 27 February. The new 11-member board at the camera and medical device manufacturer consists of the company's bankers, major investors and other related parties – falling disappointingly short of what F&C and foreign shareholders had been demanding.

Olympus had been forced by investors, regulators and other stakeholders to replace its board following revelations that it had systematically covered up losses over 13 years. The scandal was originally exposed back in October by its own newly-appointed Chief Executive Michael Woodford, who questioned and cast doubts about large secret payments made to advisors in relation to a takeover. Instead of getting answers from the board, he faced a wall of silence and was ultimately sacked. This started a calamitous chain of events that led to the shares plummeting, a major police investigation, and an independent committee describing management as "rotten to the core". The company eventually bowed to the inevitable and admitted to the accounting irregularities, and a number of former executives were arrested. Even by the standards of scandal-prone Japan this was truly shocking, and led to much soul searching amongst the country's politicians and business leaders.

The resignation of the incumbent board was an essential first step in the company's attempts to rebuild confidence in the market. However, the new board does not offer the break from the past that investors had hoped for. The new chairman will be Yasuyuki Kimoto, a former executive at Sumitomo Mitsui Financial Group (SMFG), Olympus' main creditor. There is an outside director from another of the company's banks Mitsubishi UFJ Financial Group (MUFG) and an auditor from its biggest shareholder Nippon Life. Arguably the biggest concern is that the new President Hiroyuki Sasa, who will manage the business on a day to day basis, is an existing marketing executive at the company.

This is a disappointment to F&C and fellow investors, who had been in intensive dialogue with the company's reform committee and its advisors. We had recommended a range of measures, foremost amongst which was the appointment of experienced and empowered independent directors with international experience on the boards of other major companies. We further specifically recommended that any board members appointed by SMFG or MUFG should not be considered independent, and should not serve on key committees.

In appointing the "usual suspects" to its board rather than outsiders who might have provided genuine challenge to the company's culture, Olympus has missed a valuable opportunity for Japan Inc. to show that it respects and listens to "gaijin" (foreigner) shareholders. F&C fears that this will be another reason for investors to be wary of the Japanese market.

Regulators have a chance to restore confidence, with the Ministry of Justice due to publish amendments to the Company Law shortly. F&C, which made a submission to the consultation, hopes that they will take a bold stance, taking steps to tackle some of the structural weaknesses in governance that allow poor practices to continue.

Shareholders will vote on the new board members at an Emergency General Meeting on 20 April. We hope that investors who are dismayed by these developments will make their vote heard, and that despite this setback the drive to improve corporate governance in Japan will move forward. F&C will continue to press for change at Olympus, and to call on Japan's domestic institutional investors to join with their international counterparts to push for real change.

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