reo® viewpoint

Bertille Presta, Analyst, Governance and Sustainable Investment July 2012

A Shareholder Spring à la mode française

'Rewards for failure' is how many **Carrefour** shareholders viewed the French company's plan to pay a hefty package to its outgoing Chief Executive, Lars Olofsson. The world's second largest retailer offered €1.5 million in non-compete fees, an annual pension of up to €500,000 and relaxed vesting conditions attached to stock options and performance shares to Mr Olofsson, who also served as its Chairman.

Mr Olofsson had presided over the company during three years of poor performance. Since taking over at the helm in January 2009:

- Shares have slumped 45%
- Market share in France has fallen
- Annual profit fell from €1.27 billion (2008 FY) to €0.37 billion (2011 FY)
- Carrefour announced five profit warnings
- Mr Olofsson committed €1.5 billion on an unsuccessful strategy of revamping aging edge-of-town superstores, at a time when consumers preferred smaller local outlets

Having failed to turn around the company's fortunes, Mr Olofsson was replaced earlier this year. Carrefour put his golden good-bye package to a shareholder vote at the AGM in June. In an unprecedented expression of discontent, 48.7% of investors have voted against or abstained on the arrangement. The company officially announced the voting results on 3rd July. The fact Mr Olofsson, aged 60, would receive an annual pension of up to half a million euros if he chooses not to work elsewhere, while also getting paid €1.5 million in non-compete fees, added salt to the wounds of investors.

Rewards for failure

F&C has been actively concerned with Carrefour's strategic direction, financial performance and corporate governance, which has been woven into our dialogue with the company starting in 1999. Since then, we have achieved 14 milestones with the company on a series of issues, ranging from nutrition and sustainability reporting to business ethics and supply chain labour standards. Following the announcement of Mr Olofsson's departure, F&C wrote to the head of the Remuneration Committee that the severance arrangements granted to the departing Chairman-CEO were rewards for failure. Given his age and the substantial additional pension benefits linked to not seeking employment, we questioned the rationale behind paying Mr Olofsson a lump sum of €1.5 million to prevent him from going to a competitor. The company has not responded to our query, and we cast our votes in opposition to the severance arrangements.

Despite the high level of investor dissent to this severance plan, Carrefour is proceeding to pay Mr Olofsson without a public comment to shareholders thus far. F&C believes Carrefour owes its investors an explanation about how it interprets this notable vote and the board's plan for avoiding such problems in the future. We understand that companies will not be able to keep all shareholders satisfied on every issue, but an active review of remuneration and ongoing engagement with concerned shareholders is in order.

A Shareholder Spring à la mode française

This incident was particularly notable because, unlike in the Netherlands, the UK or the US, investors do not have a formal 'say on pay' in France so cannot respond to most compensation arrangements. However, they do have the right to vote on severance terms for departing executives. This incident adds a prominent French example to the growing list of powerful votes of protest cast by investors against management around the world in 2012.

In the US, where investors are in the second year of voting on executive pay, there have been major cases. The most publicised was at **Citigroup** where 55% of shareholders rejected the company's executive pay plan. Last year, the CEO Vikram Pandit received $15 million in compensation as the bank's share price tumbled by almost half.

In the UK, investors have made their objections to excessive executive pay heard loud and clear at many major companies. High profile victims include Andrew Moss who quit as boss of insurer **Aviva** and Martin Sorrell, the CEO of advertising giant **WPP**, whose pay rise shareholders rejected. Shareholders also made their discontent heard at **Barclays**, **Prudential** and **Trinity Mirror** among others.

Carrefour is not the only French company, where investors have shown their teeth. 46.8% of shareholders opposed severance packages for top management at **Publicis** and 43% voted against or abstained on the auditors' special report on related-party transactions and non-compete agreement with CEO Frédéric Oudéa at **Société Générale**. F&C voted against both these companies' plans.

The increasing incidents of investor revolts have been dubbed in the newspaper press as the 'Shareholder Spring'. The Carrefour vote, coupled with changes at the government level, confirms that a Shareholder Spring has arrived in France.

F&C Investments

Enter Hollande stage left

The Carrefour vote comes at a time of a political shift in France as a Socialist government under the leadership of President François Hollande comes into power. His early acts include finalising plans to limit directors' remuneration at state-owned companies – capping pay of the highest-earning director to 20 times that of the lowest-earning employee.

Between these shifts in the government's approach to pay and the new willingness of investors in French companies to assert their rights of ownership and oppose the payment of rewards for failed performance, French companies are facing a new remuneration landscape. These developments will ensure France will remain firmly at the forefront of how to incentivise executives effectively.

F&C will continue encouraging companies to engage shareholders in regular constructive dialogue and engaging regulators to ensure investors have the appropriate tools to hold boards to account in the most effective manner. F&C believes that this is the best approach to achieving the best course of action across all markets without the need for heavily prescriptive new regulation.

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reo® viewpoint

Mirza Baig, Director, Governance & Sustainable Investment

August 2012

Vedanta Resources - two steps forward, one step back

Vedanta Resources, India's London-listed mining giant, has certainly been no stranger to controversy in recent times: its annual general meetings have repeatedly been marred by elaborate protests, including Avatar-themed pickets remonstrating against alleged human rights abuses. This year, media focus has shifted from now aborted plans to mine bauxite in the sacred Niyamgiri mountain range in Orissa to a $2 million political donation in India. Although a ten-fold increase over the previous year's budget, this is nevertheless a steep drop from the $3.2 million Vedanta paid in 2009. Moreover, press reports highlighted the fact that these donations occurred during a period that coincided with the approval of the company's acquisition of **Cairn India** and the resolution of a dispute with **ONGC**, the state-controlled oil and gas company, regarding a highly contentious royalty split.

London Premium Listing comes at a price

The political donations controversy is yet another chapter in the soap opera that has engulfed the company since its listing nearly a decade ago. In the face of fierce public criticism, Vedanta management has often been surprised and bemused at being caricatured as a pantomime villain during the UK AGM season. The company's problems originate from the fact that it started life as a relatively small family-run Indian copper company, before experiencing astronomical growth under the leadership of Chairman Anil Agarwal. During this period, its governance practices and culture have not kept pace, and while not unusual by Indian standards, they have stood out within a UK context, given Vedanta's move to become the first Indian company to seek a Premium Listing on the London Stock Exchange. As such, the company has struggled with the added scrutiny and expectations that accompany the prestige of a listing on London's Premium segment[1]. Vedanta's acceptance into the Premium segment opened the doors for its inclusion into the FTSE 100 stock index.

They said...

“Perhaps India's tycoons could employ their celebrity usefully, by spelling out in public how a more rational tax system would spur growth, ... or how giving public-sector monopolies a boot up the backside might improve ordinary Indians' lives. They could denounce graft and even volunteer to be more transparent in their affairs. It might backfire. But someone needs to make the case for reform.”

The Economist, 18 August 2012

The two million dollar question

It would be easy simply to label Vedanta as a bad apple and move on. However, this would be an injustice not only to the company, but to the value of effective stakeholder engagement. Over the past two years, a diverse range of stakeholders, including F&C, have had extensive dialogue with the company about cleaning up its sustainability practices and image in the wake of serious health and safety failings as well as the mismanagement of the proposed expansion of its key aluminium refinery in Orissa. After initially failing to recognise the seriousness of shareholder concerns, the Board finally accepted the need for change and adopted an agenda of reform. This included the appointment of a respected Chief Sustainability Officer charged with the task of overhauling Vedanta's social, environmental and ethical strategy, policies and practices. Vedanta has since established a clear roadmap for change, and in quarterly update meetings with the company, F&C has been satisfied with the progress made to date.

Management had hoped that this would be the year that the company could draw a line under the past and instead focus the 2012 AGM (28 August) on the significant restructuring of its group subsidiaries, its potential game-changing acquisition of Cairn India, and the positive changes to its sustainability policies and practices. However, following the publication of what the Board may well have considered to be a fairly innocuous statement in the Directors' report, Vedanta yet again faces the threat of investor backlash. Following disclosure that the Board sanctioned $2 million in political donations in India, shareholders are now considering whether to refrain from signing off on the report and accounts. Any such negative vote would be, at best, largely symbolic, due to the legal framework in the UK and the fact that the Agarwal family has maintained a majority stake in the company. Nevertheless, the negative headlines and protest vote by minority shareholders would be a blow to management as it seeks to rebuild the image of the company.

[1] The LSE introduced the Premium and Standard segments in April 2010, in response to a reform of the listing rules by the UK Financial Standards Authority that was prompted by intensive market engagement led by F&C. The Standard segment imposes much less stringent governance and reporting requirements than the Premium segment.

F&C Investments

Business and politics don't mix – or do they?

Much has been said about whether or not business and politics make good bedfellows. F&C's view is that business engagement in public policy is not only inevitable, but necessary and potentially beneficial – provided it is undertaken in a fully transparent and accountable manner. And therein lies the rub, as both donors and recipients often have an incentive to keep quiet on both the scale and nature of their relationships. F&C considers that, insofar as companies operate within regulated environments, their perspectives are necessary, together with those of all other stakeholders, to enable policymakers to form a balanced and informed view. However, policy positions and the nature of corporate engagement should be publicly disclosed.

The case for financial contributions is more tenuous: in young democracies with emerging economies, it is often difficult to fund a sufficient array of competing parties, and the case for outside funding is therefore plausible. In developed economies with mature democratic systems, the dominance of corporate funding can distort the political process and make economic decision hostage to special interest groups, thereby harming investors as well as society at large. As such, F&C strongly discourages corporate funding of political parties and candidates in all but exceptional cases. Where such practices are widespread and deeply rooted, companies should at a minimum submit their political donations policy and the past year's donations record to a shareholder vote.

Vedanta's political donations: right or wrong?

As Vedanta faces its investors once again at the AGM, it is important to look beyond the headlines and evaluate the nature, merits and governance of the company's political donations record – and in particular, consider the following:

- The Board has a formal policy that neither Vedanta nor any of its subsidiary companies may, under any circumstances, make donations or contributions to political organisations within the United Kingdom or European Union.
- In exceptional circumstances where such political donations or contributions are to be paid, they will be subject to approval by the Board and shareholders.
- This policy does not extend to donations made in other jurisdictions. Consequently, the Board approved a payment of $2 million in respect of the Indian general election with the stated aim of strengthening the democratic process.
- Payments of more than $3.5 million were reported at the time of the 2009 AGM for similar reasons.
- On neither occasion did the company provide any accounting of its payments, whether regarding the identity of their recipients or the amounts paid. It is therefore not known whether Vedanta favoured any specific parties or candidates, or sought, as suggested by its policy and dictated by best practice, to spread its funding in a neutral fashion across several recipients so as to promote constructive democratic debate.

Vedanta's policy commitment to strengthening India's democratic institutions through political funding is not unreasonable, per se, given that the country is home to the vast majority of the company's assets and that political stability is in the long-term interests of the company and its shareholders. This is especially true given that its ability to operate and grow is inextricably linked to the granting and renewing of government-issued licences and continued community acceptance. On the other hand, the combination of donations that rise and fall in tandem with the electoral cycle; lack of transparency regarding the nature of its lobbying or the beneficiaries of its funding; and lack of accountability to shareholders regarding this political activity raises real concerns. The problem is compounded by the fact that the donations were made in a country that, by its own admission, is battling with endemic political corruption, as evidenced by the introduction of the Lokpal Bill currently being debated in the Indian parliament.

Avoiding shareholder mistrust

In summary, the issue at hand is less the Board's decision to seek to strengthen the political infrastructure of India than it is the company's weak processes surrounding the decision. We consider it alarming for a UK-listed issuer to have such undocumented approaches to political donations in a jurisdiction with high corruption risk, and object to shareholders being stripped of the right to approve such donations outside of the EU. This approach is at odds with the spirit of the UK listing rules and opens Vedanta up to shareholder mistrust, reputational risk and potentially regulatory investigation.

There is no reason to doubt Vedanta's good intentions in strengthening the political and business environment within its most critical market, nor that the Board's decision to approve the donations in India were made in good faith. However, the decision to engage in the political process through the issuing of cash payments, coupled with the lack of transparency and accountability behind the decision, have served to undermine trust with minority shareholders and provide more fuel for the company's many critics.

The recent appointments of a Chief Sustainability Officer and a well regarded non-executive director are positive indicators that a cultural change is starting to take place across the Group. However, this incident has served to highlight that these changes have considerably further to go as Vedanta demonstrates that it is ready to fully embrace the rights, responsibilities and expectations of a UK-listed company.

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reo® viewpoint

Karina Litvack, Head of Governance & Sustainable Investment

September 2012

The US and the EU announce tough new transparency rules for oil and mining companies

In late August, following two years of heated debate between industry and stakeholders, the US Securities and Exchange Commission (SEC) adopted rules requiring extractive companies to report all material payments to governments in their worldwide operations. Buried within the 2,319 pages of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Section 1504 sets a tough new standard for companies whose tax, royalty, bonus and other contractual payments often make up a major part of the GDP and export earnings of oil and mineral-rich countries. In light of the so-called 'resource curse' – where mineral wealth induces a high incidence of corruption, violence and political instability, ultimately damaging the investment climate – F&C has led investor calls for higher standards of transparency. Since 2002, F&C has:

- helped establish the Extractive Industries Transparency Initiative (EITI) launched in 2003;
- served three terms on the EITI Board;
- served on the Board of the Revenue Watch Institute, the leading extractive transparency NGO founded by George Soros;
- testified before the US Congress in support of Section 1504's predecessor bill, the *Extractive Industries Transparency and Disclosure Act*; and
- actively engaged with the SEC and EU, oil and mining companies, fellow investors and other stakeholders in the run-up to the passage of this ground-breaking regulation.

What does the rule say?

The SEC rule compels all oil, gas and mining companies whose equity and debt securities are registered in the US to publish audited figures for all official payments above $100,000 to governments around the world. It goes considerably further than the voluntary EITI standard by demanding **disclosure on a project-by-project** basis, rather than aggregating all company payments at a country-wide level.

Why was it deemed necessary?

After nearly a decade since its launch, the EITI has secured voluntary adoption by 35 countries, of which 14 have achieved 'compliant' status. Yet despite this progress, only Nigeria and Norway of the world's largest oil producers have joined. This means that major producers including Saudi Arabia, Russia, Angola, Venezuela, Iran and others have escaped scrutiny and continue to show little sign of voluntarily embracing transparency. This allows corruption to flourish, imposing enormous burdens on local populations in terms of wasted resource revenues, while exacerbating geopolitical instability, increasing operating and political risks, and deterring investment.

Why was there such a battle?

Although broadly welcomed by the mining industry, several oil and gas sector players (including **ExxonMobil, Chevron, Royal Dutch Shell and the powerful American Petroleum Institute**) argued fiercely against project-level disclosure. Chief among their objections were revealing commercially-sensitive information; imposing a costly reporting burden on business; and breaching the sovereignty of foreign governments who insist on confidentiality, thereby handing a marketing advantage to rivals not subject to the rule.

Others countered – and the SEC ultimately agreed – that although significant, the additional reporting burden caused largely one-off costs that were amply justified by the social and financial benefits. The SEC also concurred with proponents that the commercial disadvantages were largely overstated, due to the ready availability of such information – albeit at a price – from specialist consultants.

Industry had especially urged an exemption whenever host governments chose to prohibit disclosure – a loophole derided by activists as the tyrant's veto. This too was rejected by the SEC on grounds that it would have rendered the law ineffectual.

They said...

"Payment structures are well known in the industry. Transparency only removes the competitive advantage provided by the ability to bribe; one that US-listed companies should in any case not deploy. Despite the grumbling, most companies will benefit from a cleaner industry."

"Sunshine rules" editorial, Financial Times, August 22, 2012

For further information about F&C's formal submissions to the SEC and EU, please see: http://www.fandc.com/new/Institutional/Default.aspx?ID=82073

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So are companies without US-registered securities off the hook?

Yes and no. While most major extractive companies have US-registered debt and/or equity securities, there are smaller operators and the massive state-owned companies who will escape the rule. But these typically need to partner with established operators in order to access technology and capital, and many turn to capital markets to fund their growth. Meanwhile, the EU is in the midst of pushing through its own similar proposal aimed at leveling the playing field among companies: as F&C went to press, the European Parliament's Committee on Legal Affairs had agreed a final proposal that will go for a final vote later in 2012. Like its US counterpart, the EU proposal features project-level reporting, excludes the tyrant's veto, and sets disclosure thresholds that align with the US rules. Now talk is turning to ensuring that other major listing venues in Asia, Australia and Canada do the same.

We said...

“Low levels of transparency in most mineral-rich countries have exacted an unacceptably high toll on their economies in a manner that has impaired economic returns to investors... we [F&C] stand to gain across our broad portfolios from better reporting on payments, as this will ultimately help reduce volatility arising from pervasive corruption, economic stagnation and social conflict.”

Karina Litvack, Head of Governance & Sustainable Investment at F&C in submission to the SEC, February 2011

What's the verdict?

F&C views these laws as largely positive. Low degrees of participation in EITI by some of the biggest, most opaque oil-producing countries have required legislative efforts to fight corruption. But driving better disclosure of revenue data by oil companies is only one important tool: the multi-stakeholder approach of the EITI, which ensures active engagement by both host governments and civil society, is ultimately the best approach to fighting corruption and strengthening investment opportunities.

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