

12 July 2011

PIRC ALERTS

UPCOMING MEETINGS

Governance issues at upcoming meetings:

1. Cable & Wireless Worldwide

NEWS

2. News Corp: governance problems
3. BSkyB: a snapshot of voting
3. UK meetings round-up
3. PIRC writes to EC over IFRS
4. Voting trends in the year so far
4. Meanwhile, Southern Cross...
4. Is private equity a job killer?

QUOTE OF THE WEEK

“[P]rofit-making may be helpful in getting some people to [run care homes] but on the other hand somebody who pushes too hard for profit clearly will be down-playing the caring requirements.”

Jon Moulton on why the demise of Southern Cross may mean that care homes should be treated like utilities.¹

¹ <http://www.guardian.co.uk/business/2011/jul/11/southern-cross-jon-moulton-regulators?intcmp=239>

Cable & Wireless Worldwide AGM 21st July

Remuneration is an issue at Cable & Wireless Worldwide.

Disclosure of cash remuneration, pensions and share incentives is considered adequate. However the company does not provide expected value calculations for individual share awards. Description of overall remuneration policy is adequate and individual pay components are well described. Pay elsewhere in the company is considered when determining executive remuneration. Individual components of the remuneration package and non-executive fees are adequately described. Contract policy is stated. The general performance conditions under the annual bonus are disclosed, but the targets are not quantified.

The company operates some Legacy plans. Their main plan is the Performance Share Awards (Long Term Incentive). The company makes use of 2 performance criteria: Absolute TSR and Absolute EPS, each representing 50% of the achievement of the full award. PIRC views the use of performance conditions in a concurrent way to be best practice. Moreover, in our view if TSR is selected relative TSR growth is preferred and the remuneration committee should ensure that a suitably large peer group of companies is identified, who should be subject to the effects of similar external factors. If TSR performance is compared against an index, additional information should be disclosed on how this compares performance against the competitor group. Cable & Wireless Worldwide does not have this approach. Also, without a base year to judge progress, it is difficult to assess the stretching nature of such a long term incentive structure. The Company has advised that they consider the targets to be challenging. The company paid no bonuses for the year under review. The former CEO and CFO were awarded performance shares representing 400% of their base salaries. This is viewed as being excessive. Although, we welcome the company's decision to reduce awards to 300% of base salaries in the future, this level is still high in PIRC's view. The Company has also informed that Tim Weller will forfeit the award of performance shares which had a face value of £2m which were awarded to him in August 2010. Also, Jim Marsh also forfeited his PSP and LTIP awards following his resignation.

All directors have one year rolling contracts, however, longer notice periods may apply initially where this is required to secure the services of executives in exceptional circumstances. The company does not have any provision for termination benefits.

We recommend that shareholders oppose the remuneration report.

News Corp: governance problems

The controversy around News International and its owner News Corporation escalated last week, no doubt leaving shareholders struggling to keep up.

This time last week we speculated that the reputational risk posed by the News of the World phone hacking scandal was likely to have a financial impact. That, it turns out, was something of an understatement. Since then the paper has published its last issue and closed (though it may yet rise again under another name), parent company News Corporation's attempted takeover of BSkyB has been delayed, if not scuppered, and the share prices of both companies have declined.

News Corp's shock decision to shut the News of the World was accompanied by the equally surprising decision to retain News International chief executive Rebekah Brooks. This has led to speculation that this is a strategy to make her the lightning rod for criticism whilst further revelations about the practices of News of the World emerge. Instead there is speculation that Dow Jones chief executive, and close confidant of Rupert Murdoch, Les Hinton could be offered up as the sacrificial lamb.

In shutting NOTW a profitable business has been closed. Rumours of the rapid emergence of The Sun on Sunday look well founded, though there is speculation about the future of all NI titles. News Corp may face other financial challenges. According to The Telegraph the company could potentially face an expensive case under the US Foreign Corrupt Practices Act because of alleged illegal payments to police officers in exchange for information.²

The hacking scandal has also, of course, taken on a significant political angle. The Prime Minister has come in for sharp criticism, even from some Conservatives, for his appointment of ex-NOTW editor Andy Coulson, arrested last week in the hacking investigation, as his director of communications. On Monday further news broke that phone hacking and 'blagging' (obtaining confidential information by deceit), possibly including other News International titles, had also taken place in relation to the Royal Family and former Prime Minister Gordon Brown.

More significant for shareholders is the pressure this may put on the News Corp bid to take control of BSkyB. Rapidly changing events have meant that the policy lines on the status of the bid changed throughout the day on Monday. Already Culture Secretary Jeremy Hunt had delayed a decision on the bid, due to the flood of submissions received on it. Subsequently it was announced on Monday morning that he had written to both Ofcom and the Office of Fair Trading to seek advice. However News Corp in turn announced that it was withdrawing undertakings relating to Sky News that would enable the company to avoid having the bid referred to the Competition Commission. This means that, whilst delayed, there is a slim hope that the bid is still alive.

As a result Hunt announced in the Commons on Monday afternoon that the bid would indeed be referred to the Competition Commission. This effectively, though temporarily, brought the two main parties' views on the bid into alignment, as Labour leader Ed Miliband has called for the BSkyB to be referred to the Competition Commission. Miliband has also put down a parliamentary motion calling for the bid to be delayed until the ongoing criminal investigation is completed, though how this will play out now is unclear.

The fall in the share price of BSkyB shows the market is already betting against the deal going through at all. Whilst this is currently mainly a pain in the wallet for those investors who like to take a punt on M&A activity, many long-term holders of BSkyB, and News Corp, will no doubt be watching the crisis with alarm.

As a result there have already been a number of developments in the investment community. A group of US shareholders in News Corp, including the Amalgamated Bank of New York, have filed a lawsuit against the company accusing Rupert Murdoch of treating the company like "a family candy jar". According to The Guardian the language is explicit in arguing that James Murdoch must have known about "illicit news gathering practices".³ Ouch.

Elsewhere Responsible Investor reports that the chair of the Church Commissioners has said that the News Corp executives, including James and Rupert Murdoch, will eventually be tried in court.⁴ In addition the Church of England's Ethical Investment Advisory Group has written to News Corp urging that "senior executives" be held accountable.⁵ PIRC is aware that other shareholders are also considering what action to take.

It's worth remembering that, for a number of shareholders, both News Corp and BSkyB have had governance red flags for years, in large part due to the influence of the Murdoch family. Under our own governance risk model PIRC has rated News Corp in the worst 5% of the S&P500. In our most recent analysis in June this year we rated them sixth from bottom in the index.

For shareholders, and asset owners in particular, this may be an opportunity to clear out the stables. If investors share the belief that there is something rotten within News Corporation and its related companies they should push for wholesale governance reforms, and do so now. They will not have a better chance.

²<http://www.telegraph.co.uk/finance/newsbysector/mediatechnologyandtelecoms/media/8629180/Rupert-Murdochs-News-Corp-could-face-100m-bill-for-US-investigation-into-police-payments.html>

³ <http://www.guardian.co.uk/media/2011/jul/11/news-corp-shareholders-attack-murdoch>

⁴ www.responsible-investor.com

⁵<http://www.churchofengland.org/media-centre/news/2011/07/news-corporation-statement-from-ethical-investment-advisory-group.aspx>

BSkyB: a snapshot of voting

Since News Corp and BSkyB are all over the news, we thought we would do some digging into institutional investor voting behaviour.

An interesting vote to look at is the first time James Murdoch faced election as chair of BSkyB back in 2008. It's a useful test case as by 2008 there were more asset managers disclosing voting data and there was also a pretty clear breach of principle – chief exec going on to become chair. And, of course, the new chair was also the son of the major shareholder which might possibly raise a concern about independence.

So which institutional investors stood up to the Murdoch empire? Based on a quick trawl of public data, those managers we can identify that opposed Murdoch's election include Aviva, Baillie Gifford, Legal & General and The Co-operative Asset Management. State Street abstained. But a number of other investors simply nodded the appointment through.

So there's an easy question for trustees - if you held BSkyB in September 2008, what did your manager do? And if they voted for Murdoch's election get them to explain why.

UK meetings round-up

Booker Group saw a 19.7% vote against its remuneration report at the company's AGM last week.⁶

The company's RNS statement reveals that a further 3.6% in abstentions. PIRC had recommended opposition.

At 3i Group there was a 29.3% vote against the resolution seeking to renew the company's LTIP, with 8.8% abstaining.⁷ PIRC had recommended opposition. The company also saw a 4.2% vote against the resolution seeking authority to call meetings on 14 days notice.

At smallcap Robert Wiseman Dairies there was a 17% vote against the re-election of non-executive Ernest Finch.⁸ PIRC had recommended opposition as we did not consider him independent due to length of tenure on the board.

At JD Sports there was a 16.7% vote against the remuneration report.⁹ PIRC had recommended opposition.

PIRC writes to EC over IFRS

PIRC has written to European Commissioner Michel Barnier to ask how the EU came to adopt defective accounting standards at odds with the law.¹⁰

Specifically PIRC has asked the Commission to ascertain whether EFRAG (the European Financial Reporting Advisory Group the private sector body the EU has used to advise it) has ever used any objective yardstick by which to assess whether any International Accounting Standards Board ("IASB") accounting standard does in fact give a "true and fair view". Or, as seems to have been the case, whether EFRAG judged "true and fair" based on a plurality of its subjective opinion rather than objectively referring to the law.

PIRC has also highlighted the consistent presence of the large accounting firms, and their trade association, the American Institute of Certified Public Accountants in the development of the faulty accounting standards.

From the evidence PIRC has assembled, it seems that Europe adopted a catastrophically defective standard causing corporate governance (which is dependent on reliable accounts) and banking regulation (which is dependent on the same accounts) to fail where the standard was used in banking companies.

This was due to:

- The IASB adopting an AICPA proposal that even the US authorities rejected.
- EFRAG with coincident interests with the membership of the AICPA, then recommending adopting it, despite clear conflicts with both EU law and the law of particular member states.

A consensus is emerging at a senior level that faulty accounting standards played a significant role in the financial crisis. In the last month both the Irish Central Bank and the Bank of England have confirmed that IFRS accounts are unreliable to establish whether a bank showing capital in its accounts does in fact have capital.

More information on PIRC's analysis is available here:

<http://www.pirc.co.uk/news/pirc-responds-sharman-and-writes-ec>

6 <http://www.investegate.co.uk/Article.aspx?id=201107061438498188J>

7 <http://www.investegate.co.uk/Article.aspx?id=201107061512039048J>

8 <http://www.investegate.co.uk/Article.aspx?id=201107061501099031J>

9 <http://www.investegate.co.uk/Article.aspx?id=201107081634250898K>

10 <http://www.pirc.co.uk/sites/default/files/PIRC%20EU%20Commission.pdf>

Voting trends in the year so far

Given that we're now past the halfway mark this year, PIRC has analysed voting trends at UK companies in the first six months of 2011.

As you might expect, remuneration is the issue over which companies can typically expect the most opposition. Looking at the results from 287 UK AGMs in the first half of 2011, we found the average oppose vote on a remuneration report was 6.1%, with the average abstention 3.14%. This compares to equivalent figures for the whole of 2010 of 5.6% and 2.4%. And if we go back to 2008, the year the crisis hit, the average oppose was just 3.3% with an average abstention of 2.2%.

What seems to have happened over the past few years is an increase in opposition across the board. Whereas back in 2008 an amazing 82.6% of remuneration reports were passed with a vote against of less than 5%, by the first half of this year the figure had dropped to 66%.

So which issue runs remuneration comes a close second in terms of the average level of shareholder opposition? Director elections maybe, or auditor appointments, or perhaps changes to share structure? No. It's those resolutions seeking authority to call meetings on 14 days notice. The average oppose vote so far this year has been an incredible 4.5%, with the average abstention at just under 1%. Whilst it is obviously the right of shareholders to prioritise their own concerns, this strikes us ridiculous and is likely the result of non-UK investors blindly following a recommendation from a third party adviser.

In comparison, the average vote against a director election in the first half of this year was 1.7%, and the average vote against an auditor appointment was just over 1%. In PIRC's opinion these issues are far more important to the governance and oversight of public companies than the ability, entirely within the law, to call meetings on short notice.

Meanwhile, Southern Cross...

Despite all the attention focused on News International and BSkyB, it's worth noting that another problem UK company, Southern Cross, is about to shut down.

On Monday trading in the company's shares was suspended, and the company announced that its 750 homes were being taken over by the landlords. Once the handover has been completed Southern Cross will cease to be a care provider.

The company's demise has led to a call from private equity chief Jon Moulton for care home providers to be run like a regulated utility to prevent too much pressure for short-term profit. Critics of Southern Cross have highlighted the involvement of private equity as a contributory factor in its demise. Former owner Blackstone initiated the "sale and lease back" model that has caused the company serious financial problems.

Is private equity a job killer?

Socially responsible private equity is one the 'big ideas' in the responsible investment world currently. But what is its record on employment?

The latest study on this hotly-debated topic suggests that there is a "significant decrease" in employment in acquired firms the year after the buyout. The study also claims that there is little evidence of an increase in productivity or profitability either. No doubt the claims will be contested, but it's an important corrective to the idea that private equity, by reducing the agency problem, is a 'better' ownership model. It has downsides too.

11 *Private Equity Takeovers and Employment in the UK: Some Empirical Evidence*, featured in *Corporate Governance: An International Review*

PIRC advises institutional investors with assets in excess of £1.5 trillion.

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