SEASON’S MEETINGS: RECORD FAILED SAY-ON-PAY VOTES THIS US PROXY SEASON

HARD-WIRED GOVERNANCE: AN INTERVIEW WITH BAILLIE GIFFORD’S ANDREW CAVE

VOTING NEWS

PROXY MONTHLY
This month has been a mixed bag for UK issuers. Last week, we saw one of the largest ever shareholder rebellions against a remuneration report, with Royal Mail incurring a massive 70.2 percent opposition. Gavin Patterson was also given a slap on the wrist as he resigned from his role as BT’s chief executive. Investors in the telecommunications firm expressed their distaste with his £1.3 million bonus, with 34.2 percent of votes cast against the company’s remuneration report.

However, for the rest of the UK, shareholder defiance has proven more illusory, with the predicted revolts this month at TalkTalk and Burberry failing to materialize. More nerve-racking was the survival of chief executive Gavin Darby at Premier Foods. Oasis Management narrowly failed in its bid to oust Mr Darby. 59 percent of shareholders voted in favor of the beleaguered CEO.

By contrast, the US has been relatively quiet this month. With its proxy season coming to an end, the country has begun contemplating further corporate reform, both domestically and further afield. For instance, this month Glass Lewis became the first foreign proxy adviser to adopt the precepts of the Korea Corporate Governance Service’s (KCGS) stewardship code.

Another example of this is State Street’s recent publishing of its efforts in 2017 to engage with companies on board diversity as part of the asset manager’s ‘Fearless Girl’ campaign. According to State Street, it engaged with 787 US, UK and Australian firms last year, 152 of which subsequently appointed a female director to their board. Due to its success, State Street plans to extend the campaign to Canada and Japan this year.

However, not all corporate governance issues saw incremental progress this month. The Securities and Exchange Commission (SEC) has apparently once again shelved plans to introduce a universal proxy card to the US market.

Unlike many other countries, the US market currently prevents those voting by proxy from picking and choosing between management and shareholder director candidates during proxy contests. Instead, they are forced to vote entirely on either the management or shareholder card. A universal proxy card would place all nominees on a single slate, thereby circumventing this issue.

Things have been much livelier in the rest of Anglophone. In both Australia and South Africa, rising executive pay and perceived corporate largesse have led to calls for future reform.

According to the Australian Council of Superannuation Investors (ACSI), CEO pay in the ASX 100 rose approximately 12 percent last year. Consequently, Wayne Swan, the new President of the Labor Party, has called for a cap on CEO pay. Similarly, according to a PwC report, CEO pay among the top ten largest members of the Johannesburg Stock Exchange (JSE) reached new heights last year. Bosses took home an average of R24.9 million. Given this gradual ratcheting up of South African executive pay, members of the JSE have come under increasing scrutiny.

One of the ways this scrutiny has expressed itself is the growing demand from South Africa’s regulators for the adoption of clawback or malus policies, especially for firms in the financial services.

Our headline interview this month is with Andrew Cave, Head of Governance & Sustainability at Baillie Gifford. In the interview, we discuss ESG integration and the difference between ESG and ethical investment.

This month’s article looks at the voting trends in the recently-concluded US proxy season. Our analysis illustrates that this proxy season saw considerably more failed Say-on-Pay votes than in previous years. It also shows a dramatic increase in the number of proposals on shareholder rights topics.

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Another proxy season has come to a close. For Proxy Insight, that means it is time to look at our voting data and see what trends defined US meetings this year.

Management Proposals

Average support for management proposals remained entirely unchanged from last proxy season, standing at 94.7 percent. However, while the overall balance might be the same, this masks some interesting changes in the trends that make up this figure.

Executive pay is rarely out of the spotlight, but opposition hit new highs this year. The season saw 67 US Say-on-Pay votes fail to win over a majority of shareholders. This is much higher than last year’s figure (38) and, as Table 1 shows, more than in any of the preceding three proxy seasons.

However, as you can see from Table 2, the rise in failed Say-on-Pay votes was not matched by a similar rise in investor revolts (which we defined as over 20 percent opposition). There were 364 Say-on-Pay revolts in the US this year, compared to 371 last year. This suggests that shareholder resistance was ‘deeper’ as opposed to ‘wider.’

Not all aspects of pay were so contentious. Resolutions to approve omnibus stock plans were more readily accepted by investors this year than last. The 2018 proxy season saw four of these resolutions fail and 120 receive at least 20 percent opposition. Last year, on the other hand, there were five failed stock plans and 177 revolts.

Auditor ratification made headlines early in the proxy season. Traditionally this has been a thoroughly routine proposal, enjoying at least 99.7 percent support on average in each of the previous three proxy seasons.

However, a couple of high-profile cases brought out suggestions that shareholders might be starting to hold auditors accountable at companies with governance issues. Specifically, ISS and Glass Lewis recommended that shareholders oppose the ratification of KPMG at General Electric, and Glass Lewis made a similar recommendation at Wells Fargo.

In the end, General Electric’s reappointment of KPMG — continuing a 109-year-old relationship — faced a rebellion from 35.1 percent of shareholders.

At Wells Fargo, on the other hand, the firm’s ratification as auditor received 91 percent support, which, although low for this resolution type, was not exactly a firm statement of opposition.
In the Proxy Season as a whole, the matter of auditors turned out to be a very small issue, magnified by a couple of high-profile controversies. The average support level this season fell noticeably but modestly to 98.6 percent. The rise in the number of resolutions facing revolts was equally small, ticking up from 16 to 18.

Shareholder Proposals

Support for shareholder proposals was up almost a full percentage point this season. The average shareholder resolution received 32.9 percent support, compared to 32.0 percent last year.

When it comes to shareholder proposals, many had high hopes for ESG issues this proxy season. Last year was a landmark season for ESG, with a number of prominent victories for shareholder proposals on climate change in particular. Things did not hit the same heights this year.

Some of the key resolutions that succeeded last year asked for reports on the risks associated with the two degree scenario, as outlined in the Paris Agreement. The high-profile resolutions that succeeded at ExxonMobil and Occidental Petroleum both fell within this category.

However, things tailed off a little for two degree proposals this year. There were no further headline-grabbing victories, and average support fell from 45.4 percent to 35.7 percent. As Table 3 shows, the number of resolutions placed on company ballots also fell, from 17 to eight.

Shareholder rights seemed to be a key focus point for proponents this year. Proposals to amend the right to call a special meeting were the single most prominent type of shareholder resolution.

We already studied this topic in last month’s issue, so we will keep this month’s analysis brief. We picked up 61 of these resolutions, more than any other shareholder proposal type and a big increase on the 20 that were tabled last year. Support for amendments to special meeting rights averaged 41.1 percent — well above the average, but little-changed from last year’s 41.3 percent despite the number of resolutions put forward.

The second most popular topic for shareholder proposals this year was political or lobbying contributions. 57 proposals were tabled asking companies to report on these payments this year, although this is down from 68 last season and over 70 in previous years.

Proxy access has been an interesting beast when it comes to shareholder proposals. Over the past couple of years, the number of resolutions seeking to amend proxy access provisions has risen significantly. There were 13 in the 2016 season compared to 33 this year.

Support, however, has fallen just as drastically. In 2016, these proposals received 43.2 percent support from shareholders on average, but this year that was down to 27.8 percent.

As Table 3 shows, the rise in proxy access amendment proposals in the last few years has corresponded with a similarly steep fall in the number of proposals seeking to provide proxy access.
Presumably, this is because more and more companies have been adopting proxy access. This obviously makes proposals asking them to do so less relevant, but opens up more companies to amendments instead.

Proxy Contests

One of last year’s major talking points was Nelson Peltz’s activist campaign at Procter & Gamble (P&G), the largest company ever to find itself embroiled in a proxy contest.

This year, on the other hand, was lacking in high-profile proxy contests. The most heavily-reported was certainly Broadcom’s attempt to install directors on the board of Qualcomm ahead of a takeover attempt. This was shaping up to be a bitter conflict. Although reports suggested the dissident was expected to win, the contest was blocked by the President on national security grounds before it went to a vote.

Another headline-grabbing battle for board seats took place at SandRidge Energy, where dissident Carl Icahn ultimately won control of the board. Four of his nominees were successfully elected by shareholders. The fate of another seat was so close-run as to be open to dispute, so the two parties reached an agreement which expanded the board from seven to eight directors and appointed a fifth member of Mr Icahn’s slate.

However, to observers in the governance world one thing about the SandRidge meeting was arguably even more interesting than the battle. It was the first US proxy contest to adopt a universal proxy card.

Proxy advisers were quite split on dissident campaigns this year. As you can see from Table 4, ISS increased its support for dissident director nominees, while Glass Lewis sided more with management.

However, only a few proxy contests take place each year, so this data can only ever be derived from a small sample size.

Conclusion

This proxy season has been one of both large and small shifts. Shareholders have become a little more supportive of shareholder proposals, but not at the expense of management resolutions. More radical changes include the large increase in the number of failed Say-on-Pay votes, and in the number of proposals on shareholder rights topics, such as special meetings and proxy access.
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Can you briefly outline how Baillie Gifford approaches its proxy voting responsibilities?

We see proxy voting as absolutely key to what we do, as we have an unusually long-term investment horizon. Our average holding period is over five years for most of our funds, so we plan to engage with companies over a number of different annual meeting cycles.

The importance of voting is becoming greater each year, as fewer and fewer resolutions receive the full support of all shareholders. Indeed, the scrutiny that voting involves and its potential to bring about change is increasingly evident. We endeavor to vote every single holding for our clients. We do not have any kind of minimum cut-off or threshold for voting.

We do all of our voting in-house. Although we do use third-parties for background research, we also have an analyst in our team looking at every single meeting we vote on. They carry out bottom-up analysis, working in concert with our investment managers to come to a voting decision. This process is conducted through our own bespoke voting platform, which we built several years ago for that purpose.

A couple of years ago we looked like an outlier in this area, but I think other investment firms are now investing in similar processes and are at least gradually heading in a similar direction to us in terms of doing more in-house.

We are able to say to our clients that we do investment-led voting, which is underpinned by analyst research. To deliver this we have a large team of thirteen employees working on governance and sustainability issues at Baillie Gifford.

In your latest set of proxy voting policies, Baillie Gifford changed the name of its ‘Corporate Governance Team’ to the ‘Governance and Sustainability Team.’ What are the reasons for this change?

We had always looked at environmental and social issues under the broad banner of corporate governance issues. Managing sustainability issues and stakeholder relations is just part of good corporate governance.

However, we felt that the new name was a better marker for what our team was actually working on, as we are increasingly doing research on sustainable business issues like climate change and labor relations. We also do not particularly like the rather awkward acronym ‘ESG’, and reached the view that governance and sustainability was a better fit for our firm.

Baillie Gifford supported Tesla’s pay plan for retaining Elon Musk back in March this year. What were your main reasons for supporting the plan?

Tesla was one of the more interesting pay plans we have looked at in recent years. We engaged with Tesla on the subject ever since the company first signaled that it was looking to renew its plan, which involved discussions with Tesla board members.

For such an unusual company as Tesla, which is working very hard to disrupt not just one but multiple industries at once, it was really a special case for us. The leadership that Elon Musk has brought to the company has been decisive in getting Tesla as far as it has.

We discussed Tesla’s plan across a number of our internal funds and reached the same decision. Our investment teams and governance analysts debated all the pros and cons of the plan. There were some we liked, others that we were less sure about, but in aggregate we decided that it was the right plan, for the right time, for the right leadership at Tesla.
It fully incentivizes the CEO over an unusually long period – we liked the fact that the plan was very long-term. Many companies talk about three-year long-term incentive plans. In our opinion, those are not nearly long-term enough for most product cycles. Tesla’s ten-year plan is a much better fit for their business.

We like the fact that the plan did not just progressively ramp up options for success, but also included a commensurate reduction of base pay and short-term targets to nothing in this case. If the company does well, both our clients and Elon Musk will do very well. So, there is a good alignment over the long-term between our interests and those of the company.

For all those reasons, our various holders came out in support of the plan. We now look forward to seeing what Tesla can achieve in the coming years.

As an investor with a considerable portfolio in Japan, what would you say are the main areas for improvement in terms of corporate governance in the country?

We have been very encouraged by how much improvement there has been over the last couple of years. Japan has one of those very interesting cultures where voluntary government initiatives can actually have real traction. In other markets, guidance from the top can have some impact, but maybe not as much as we would like to see.

By contrast, in the Japanese market there has been a very significant impact precipitated by a change in tone from the top and the progressive work of the government pension fund (GPIF). We are seeing a lot of interest from Japanese companies not just in corporate governance, but also in ESG more generally. We find this all very reassuring.

The largest change in Japan's corporate governance climate to date has been the introduction of more independent directors on boards. However, there is still more work to do in this area. We would like Japanese companies to have the foresight and confidence to appoint independent directors with no prior connection or allegiance to the firm. We expect Japanese companies in the future to appoint more international and female directors, as well as directors from completely different sectors and backgrounds, in order to provide their boards with different perspectives.

What steps are you taking to integrate ESG considerations into your investment process?

We at Baillie Gifford see ESG as a commercial discipline. For us, it involves fully weighting in the risks and opportunities confronting companies in the years ahead from things like climate change, data privacy, labor relations, etc. Our commercial definition of ESG means that we aim to fully integrate it into all of our funds, as there is no reason why we would not.

I generally separate our work in ESG from the interest of some of our clients in ethical investment, which I see as conceptually different. Ethical investment involves attaching minimum standards to portfolios irrespective of any impact upon performance. Indeed, one of the challenges that we face is the continual overlapping of these two concepts. We believe that they should be kept separate, given their differing objectives.

Practically speaking, as noted earlier, we have a large team of governance and sustainability analysts here at Baillie Gifford, who work very closely with our investment teams. We join portfolio construction groups, attend stock meetings, publish research, write-up notes from conferences and share them internally, etc. So, there is a lot of momentum around the integration of ESG considerations across the firm.

We would really like to see the acronym ESG disappear in time, as it moves from a separate research construct to one that is an organic part of good long-term investment.

We are also currently learning from the experimentation that we are doing with some of our newer funds. For instance, we have a fund called Positive Change, which builds deep, fundamental impact research into the process for choosing stocks, with the aim of investing in highly sustainable companies that are supporting the UN Sustainable Development Goals through their core business activities.

Another of our products, Global Select, involves a three-step ESG integration process. The first is a compulsory ESG pre-assessment for all potential holdings, covering relevant risks, concerns and opportunities involved in the investment.
This is followed by full participation at all stock meetings from the governance team and finally an engagement process to robustly follow up on any issues or concerns. This is just one example of a process where ESG is hard-wired into the system and becomes a fundamental part of the end-to-end process.

What is Baillie Gifford concentrating on this year in terms of corporate governance?

As a team, we are very much focusing on how we can carry out deeper fundamental research on our portfolios. We are currently thinking about the best way to do that in terms of the integrated processes involved, the sources we should be pulling information from and how we can share this information and analysis at the right stages in the investment processes.

In terms of industry issues, there are a number of fairly well-established themes. We are again thinking about pay this year. Although it is a perennial theme, there seems to be renewed interest around executive compensation in a number of markets. Like many other asset managers, we believe that there must be a better and simpler way than the complexity of the current approach taken by many companies.

We have also seen significant client interest in climate change and carbon emissions, an area other managers are also concentrating on. However, we are trying to go further in our analysis than just the basic benchmarking of scope 1 and 2 emissions for our holdings. We are thinking about the actual key enablers of transition. Specifically, which companies are helping the shift towards a more sustainable economy despite their own carbon footprint?

A good example of this is Philips Lighting, which is a global leader in LED illumination. The question that emanates from this is how do you quantitatively weigh the long-term impact of a company’s products into an assessment of a company? Namely, how do you capture the full costs and benefits of what a company is doing across its value chain?

We are also looking at a number of social issues at the moment. There has been a lot of public and regulatory interest in tax, privacy and data protection in recent years. ‘Data governance’ is the combination of data security oversight and the prudent use of customer data.

It is likely that in the future we will see even more focus on the board’s role in data governance, with more directors who build specialist knowledge in this area, which is something that we would encourage.

Labor relations is a social issue that has also been an important consideration this year. At a lot of different companies, we are seeing testing of the boundaries between ‘traditional’ employees and those in the flexible work economy. Some of these changes are being challenged through the court system, whilst others are being opposed by various stakeholder organizations.

This is an interesting time in terms of the relationship between companies and the people who deliver their products. Proposed revisions to the UK corporate governance code may see directors taking on more responsibility for all workers involved in delivering the company’s products, not just core employees.

If Baillie Gifford could introduce one corporate governance reform what would it be?

As an investment manager we believe that we should look at the fundamentals of each company both as an investment and also in terms of their governance. We are very open to the fact that you can have different types of governance, which might lead to better outcomes than a tick-box approach.

That said, I am increasingly of the view that there should be some international basics around corporate governance, which currently are not there given the lack of a global standards body on the matter. Unusually for an area of business, there are literally hundreds of different laws, codes of practice and marketplace norms worldwide.

As a result, I would like to see some convergence of basic norms that all companies should ideally follow in all markets. This is quite different from a lot of attempts to focus on codes of best practice for the most advanced markets and companies. This would be the opposite of that – a list of things that should be achievable in every market.

Thank you Andrew.
The Global Shareholder Engagement & Activism Summit will again unite institutional investors and corporates to discuss how shareholder activism is evolving around the world and how both sides can engage in the most productive ways possible that bring a win-win outcome. This full-day program will review the shifting engagement landscape, particularly through US, Canadian, UK and European markets – as well as the role international shareholder activism plays in cross-jurisdictional campaigns. The audience will convene a cross-section of issuers, institutional shareholders, active fund managers and those supporting each respective side of the discussion.

Dialogue will include a spotlight on recent trends in global activism, and comparison of best practices as investors and companies seek to reach mutually beneficial outcomes throughout the engagement process. We invite you to join us to share your knowledge and experience, and to network with these industry leaders.

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Investors divided over MSCI’s inclusion of China-listed A shares

According to a report on Chinese corporate governance carried out by the Asian Corporate Governance Association (ACGA), almost half (48 percent) of all investors polled said that MSCI was wrong to include China-listed A shares in its emerging markets index. Only 27 percent of investors surveyed said that they thought that the index provider was correct in its decision.

The survey also showed that 59 percent of investors were unable to understand many of the unique aspects of Chinese corporate governance. These include the responsibilities of non-executive directors, the Chinese supervisory board system and Communist Party committees.

The latter is particular to the Chinese state. Last month, the Chinese securities regulator published new corporate governance guidelines that require companies listed in China to do more for ‘Communist Party building.’ This apparently includes the analysis of party theories and the performing of social activities in line with party doctrine.

Board adopts poison pill to prevent founder takeover

Following his resignation from Papa John’s International after using a racial slur during a media training session, founder John Schnatter has declared he will not cede control of the company without a fight. Consequently, its board adopted a poison pill exclusively against any attempt by Mr Schnatter to increase his 29 percent stake in the company.

Last week, the board voted to remove some of Mr Schnatter’s privileges, including his ability to use an office at the company’s headquarters in Louisville. Mr Schnatter’s attorneys are currently trying to undo the termination of these privileges.

The introduction of a poison pill to block an influential shareholder is not a new phenomenon. Last year, Avis Budget Group adopted a poison pill to prevent its largest investor, SRS Investment Management, from increasing its stake in the vehicle rental company.

Support for shareholder resolutions in Australia

A survey by the Governance Institute of Australia has revealed support for the idea of allowing shareholders to have more freedom to table resolutions at AGMs. Two out of four proposed changes received support from at least half of respondents.

Currently, shareholders of Australian companies can only put forward resolutions that relate to the management of the company if they first manage to make changes to the bylaws. The bylaw changes can only be tabled as a special resolution, which requires 75 percent support in order to pass.

The Governance Institute outlined four models of reform, originally suggested in a separate report by the Australian Council of Superannuation Investors (ACSI), and asked which ones the respondents would support. Respondents were allowed to support more than one option. 54 percent were in favor of giving shareholders the right to table binding resolutions which require a 75 percent supermajority in order to pass. 50 percent supported allowing investors to submit proposals that require a simple majority to pass but are only advisory.

A further 40 percent were in favor of introducing an ESG or sustainability report which would be subject to a non-binding vote at the AGM, similar to Say-on-Pay. The remaining option proposed a non-binding vote on the company’s annual report as a way for shareholders to express discontent and was supported by 30 percent of respondents.

New UK governance code gets mixed reactions from business

The new UK Corporate Governance Code, which was published yesterday by the Financial Reporting Council (FRC), has prompted mixed reactions in the business world. While some have welcomed the new provisions, others have reservations.
The Confederation of British Industry (CBI) and the Institute of Directors (IoD) were both among the business groups that welcomed the changes. The IoD’s head of corporate governance, Roger Barker, especially welcomed the new code’s “engagement with a wider range of stakeholders including the workforce, as well as encouragement of more long-term oriented business behavior.”

However, Mr Barker expressed disappointment that a call for ongoing professional development of directors is only advisory and not a requirement of the code. Others also felt that the code did not go far enough. For example, the general secretary of the Trades Union Congress (TUC), Frances O’Grady, said that the reforms made some progress but were “not the shakeup of corporate Britain Theresa May promised and the country needs.” In particular, she said, “The government should have stuck to its commitment to make workers on boards mandatory.”

Ms O’Grady was not the only one to have reservations on this point. Timothy Copnell of KPMG’s Board Leadership Centre praised the code for providing flexibility on workforce engagement but said “it would be unfortunate if boards were too quick to dismiss the idea of appointing directors from the workforce simply because it sits uncomfortably with the traditional UK corporate governance framework.”

HKEX postpones widespread use of dual-stock structures

This week, the Hong Kong exchange (HKEX) declared that it would temporarily postpone changes to its listing requirements. In recent years, the HKEX has weakened its stance on the principle of ‘one share, one vote’ in an attempt to become more competitive than other local exchanges and to entice up-and-coming Asian tech firms to join.

Ownership of dual-stock shares for HKEX listed companies has so far been limited to company founders. However, the HKEX had said that it would soon launch a consultation on extending these rights to other shareholders.

This consultation has now been postponed due to a lack of agreement on the issue. Many investors have expressed their concern with the dilution of corporate governance standards. On the other hand, some argue that the extension of unequal voting rights does not go far enough in attracting companies to list in Hong Kong. According to the HKEX, the exchange needs to discuss the matter further with stakeholders in an effort to develop a broader consensus on the matter.

Mike Ashley to pay his future son-in-law £5 million

Michael Murray, the future son-in-law of Sports Direct’s boss Mike Ashley, is to be handsomely remunerated for supervising the retailer’s property portfolio. Mr Murray is set to receive £5 million and the unusual title of ‘head of elevation’ if his deals prove lucrative for the company. This is despite the fact that he is not directly employed by Sports Direct and works as an external consultant.

However, if Mr Murray is to see any of this £5 million, the pay must first be waved through by Sports Direct’s three non-executive directors. The move is likely to attract substantial criticism from corporate governance advocates and Sports Direct’s own shareholders. This is not the first time Sports Direct has got into hot water for perceived nepotism. In 2017, Mr Ashley received flak for proposing his brother John be paid an extra £11 million. Apparently, John had been underpaid over an eight-year period while serving as the company’s IT director. However, the payout was voted down by investors and Mr Ashley subsequently dropped the idea.

Sorrell’s recent acquisition threatens WPP pay out

Martin Sorrell’s recent acquisition of Dutch digital production company MediaMonks has cast a shadow over the pay he is set to receive as former chief executive of advertising giant WPP. The acquisition of MediaMonks by Sorrell’s S4 Capital was confirmed earlier this week.

Last week WPP’s lawyers wrote to Mr Sorrell arguing that his acquisition of MediaMonks violated his confidentiality undertakings. As a result, the company has now threatened to discard the long-term incentive plan (LTIP) entitlements that are outlined in Mr Sorrell’s 2008 WPP contract.

Indeed, during WPP’s annual meeting in June, a shareholder questioned whether Mr Sorrell’s intention to start his own advertising company did not constitute “gross misconduct” in and of itself, thereby undermining his payouts for retiring from WPP as a ‘good leaver.’

In reply, a spokesperson for Mr Sorrell declared: “The WPP legal position has no merit.” They went on to say that the legal threats “were just a “feeble and weak attempt” to undermine the MediaMonks acquisition.

THE [UK] GOVERNMENT SHOULD HAVE STUCK TO ITS COMMITMENT TO MAKE WORKERS ON BOARDS MANDATORY.”

- FRANCES O’GRADY, GENERAL SECRETARY OF TUC
In a Changing Landscape

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