

OW Bunker and the failure in governance

Lack of transparency and conflicts of business roles are among the underlying causes of the collapse of the global marine fuel logistics firm. **BY MAK YUEN TEEN AND CHRISTOPHER BENNETT**

ON NOV 6, 2014, news broke about an alleged fraud and risk-management failure at Dynamic Oil Trading (DOT), one of the two Singapore subsidiaries of OW Bunker A/S, a Danish global marine fuel logistics company which listed on the Nasdaq OMX Copenhagen on March 28 last year.

Apparently, DOT's CEO and finance manager had extended a credit of US\$125 million to Tankoil Marine Services, a Singapore bunker supplier, without the approval of the parent's board of directors. A loss of US\$150 million was also discovered after a review of the company's risk exposure. OW Bunker and several subsidiaries then filed for bankruptcy. Two key DOT employees were reported to the authorities and the chief risk officer (CRO) was fired.

OW Bunker's initial public offering (IPO) prospectus described approval authorities for credit lines in some detail. Non-compliance with authorisation limits and poor risk management were the proximate causes of the company's collapse. However, media reports and public disclosures by the company suggest a number of underlying causes.

Organisational culture and incentives: In cases like OW Bunker, incentives (in the widest sense) and remuneration structures almost always play a part as they are a primary way in which organisational culture is created and sustained.

The company, apparently, had a culture of aggressive risk-taking. Kenneth Rosenmeyer, a former risk manager and 13-year veteran of OW Bunker, was reported to have been given the special task of securing the company major million-dollar profits by trying to "beat the market" (shippingwatch.com dated Nov 21, 2014). He said: "I had a budget that required me to make a US\$1.5 million profit every month. It was speculation." He quit in March 2014 shortly after the IPO, saying that listing would make it more difficult for him to maintain good results.

Turning to the remuneration policy, OW Bunker stated in its prospectus: "In accordance with the remuneration policy and section 139 of the Danish Companies Act, we have adopted overall guidelines on incentive pay for the board of directors and executive management, which have been approved by the general meeting of the shareholders of the company. The guidelines are available on our website, www.owbunker.com." Unfortunately, those guidelines are no longer there. The 2013 annual report and prospectus make some remuneration disclosures. The remuneration package for key management consists of a fixed base salary, a short-term cash bonus, a long-term stock option incentive, and other benefits. OW Bunker does not disclose remuneration for directors and key management on an individual basis because it considers remuneration to be a private matter.

The two members of key management were paid total fixed salaries of 5.3 million Danish kroner (S\$1.1 million) and cash bonuses of 7.6 million kroner for the year ended Dec 31, 2013. Two other key employees, including the executive vice-president (EVP) of physical distribution, were paid total fixed salaries of 3.1 million kroner and cash bonuses of 6.6 million kroner.

From this information, we can see that cash bonuses constitute a significant proportion of total remuneration, especially for the key employees. However, to assess if the remuneration policy overly rewarded short-term profitability and promoted excessive risk taking, the bonus potential (rather than bonus paid) and the performance measures used for granting and vesting cash bonuses and share-based incentives need to be considered – but, unfortunately, like many other companies, this information is not publicly available.

Conflict of roles: The EVP of physical distribu-



OW Bunker has been criticised for not being transparent about its use of derivatives for trading, and not just for hedging.

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tion also acted as CRO. A CRO advises and assists the board and senior management in implementing risk-management practices. As EVP of physical distribution, she has an important business role that entails risk taking. She clearly faced a conflict between her CRO and business roles, which would have been aggravated by a remuneration policy encouraging aggressive risk-taking.

Financial disclosure: In its prospectus, OW Bunker reported significant growth in its Singapore operations and disclosed that for the year ended Dec 31, 2013, they contributed US\$4.8 billion of the US\$17 billion total group revenues. Based on the financial statements of the Singapore subsidiaries we obtained, DOT's revenues from its incorporation on Aug 24, 2012, to Dec 31, 2013, were about US\$2.1 billion. OW Bunker Far East (OBFE), the other Singapore subsidiary, had revenues of about US\$3.3 billion in 2012 and US\$4.7 billion in 2013. DOT or OBFE were not mentioned in the prospectus and according to shippingwatch.com (Nov 14, 2014): "...OW Bunker CEO Jim Pedersen never mentioned the Singapore success story during the more than 100 meetings with investors and analysts ahead of the IPO. At least not the part about Dynamic Oil Trading. There is not one word about DOT in the 272-page prospect (*sic*), and the company is only mentioned in the annual report in a note listing OW Bunker's more than 50 subsidiaries."

OW Bunker has also been criticised for not being transparent about its use of derivatives for trading, and not just for hedging. The extremely rapid growth of its Singapore operations should probably have raised some questions from the board, senior management and other stakeholders, about business practices, risk management and corporate governance in its Singapore subsidiaries.

Subsidiary governance: We have previously published a commentary about the problems of governance of group entities, including subsidiaries ("Director's dilemma in a subsidiary", BT, Aug 15, 2012). This was followed by our report "Governance in Company Groups", published by CPA Australia and ICLIF Leadership and Governance Centre last year, which looked at the largest 50 listed issuers in Australia, Malaysia and Singapore. We cautioned that many corporate scandals and failures have their roots in group entities that often pose significant risks but whose governance receives little attention. We highlighted common intra-corporate conflicts between parents and group entities, and conflicts faced by individuals within group entities who often hold multiple roles of director, employee and shareholder representative.

We found that most listed issuers disclosed little about how they govern subsidiaries and group entities, beyond having group policies, committees having group-wide responsibilities, and basic controls like internal audits.

Group entities are incorporated as separate legal entities each with their own board of directors. These boards are often created for legal compliance and perform no substantive governance role. Individuals serving on these boards typically receive very little training on their fiduciary and other duties. The exception is financial institutions where, recently, regulators have imposed governance responsibilities on subsidiary boards. In its 2013 annual report, OW Bunker listed 52 subsidiaries, all but two being wholly owned. One subsidiary, DOT, ultimately caused the collapse of the entire group. Yet, in all the discussions about the scandal, there has been hardly any mention of the role of DOT's board. So, how were DOT and the other Singapore subsidiary, OBFE, governed?

DOT's board had four directors – Gotz Dieter Lehsten, Jim Bojesen Hessellund Pedersen, Morten Skou and Lars Moller. Mr Moller, the only Singapore resident director, was managing director (MD) of DOT. Mr Lehsten, the EVP of reselling, is resident in Germany. Mr Skou is head of strategic development and, until October 2014, CFO of OW Bunker. Mr Pedersen is OW Bunker's group CEO. Simply stated, all four directors of DOT were employees within the group.

DOT is incorporated in Singapore and its directors have fiduciary and other duties under the Singapore Companies Act. They are supposed to act in the best interests of DOT. Did the board of DOT actually perform any governance role? In making decisions relating to DOT, were the directors motivated primarily to act as employees of the group or as directors of DOT?

The approval authorities for credit lines disclosed in the prospectus indicate that the board of DOT had no role in approving credit lines – they were either approved by local managers, group credit director, group credit committee, group CEO or parent board. The board of the other Singapore subsidiary, OBFE, was comprised of two directors, both employees within the group – Mr Lehsten and Harreby-Thomsen Sonnich, the MD who is resident in Singapore.

Public reports indicate Mr Sonnich is also the trading manager of OW Bunker & Trading A/S and leads the South-east Asia centre from Singapore. The creation of separate legal entities is frequently driven by tax, risk-management or regulatory considerations. Many subsidiaries in company groups, especially wholly owned subsidiaries such as DOT and OBFE, are essentially managed like business units or divisions. "Boards" are made up solely or mainly of employees of the group and are often creations of form not substance. This leads to a governance lacuna with resultant moral hazard:

■ Directors of the ultimate parent company (in most countries) only owe fiduciary duties to the company of which they are directors, not to the entire group. In practice, they and key management in the parent company have the ability to make decisions within subsidiaries without legal accountability.

■ Directors of subsidiaries owe fiduciary duties to those subsidiaries. In reality they have limited ability or incentive to perform their governance role. Often, their employment responsibilities are more important to them. Their legal duties as directors to the subsidiary are rarely enforced.

If this state of affairs continues, we expect companies to continue to create separate subsidiaries and other legal entities and to push more risky and questionable decisions into these group entities. We can only see more trouble ahead in the governance of subsidiaries and group entities unless there is increased attention on the subject.

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