

Will New Noble be more of the same?

It'll a tough sell with the current management team remaining in place. BY MAK YUEN TEEN

On March 14, the board of directors of Noble Group ("Noble") announced the signing of a binding restructuring support agreement ("the RSA") in relation to its proposed financial restructuring. Central to the proposed restructuring is the creation of a new company called New Noble to be listed on the Singapore Exchange.

Noble's corporate governance and transparency has arguably become worse since I published a highly critical commentary, particularly about its board of directors and its remuneration policies and disclosures, following the attack by Iceberg Research ("*Noble should pay heed to its corporate governance*", BT, June 24, 2015). Unfortunately, the New Noble promises to be much like the old one.

FLAWED NOMINATING PROCESS

Back in 2015, Noble had a 13-member board which included eight independent directors who were arguably lacking in diversity, relevant expertise, independence, and ability to commit time due to their other major appointments. I said then that the way Paul Brough was appointed as a new independent director was a reflection of the company's insular nominating process, as he was a partner of KPMG Hong Kong at the same time when Noble's then audit committee chairman, Iain Ferguson Bruce, was a senior partner. The company said then that its nominating process starts with the chairman consulting individually with directors on possible candidates. Presumably, the then chairman, Richard Elman, consulted Mr Bruce, and they came up with Mr Brough.

I said then: "The appointment of Mr Brough is particularly surprising, given the public scrutiny Noble is facing. This suggests that it is oblivious to or does not care about public perceptions. Some may argue that this is a sign of hubris." There are no indications that this has changed at all.

Mr Brough took over as chairman in May 2017 and Mr Elman became a non-executive director and chairman emeritus. Concurrently, Noble commenced a strategic review led by Mr Brough. At that time, five directors resigned, including two independent directors and three non-executive directors.

The flawed nominating process reared its head again when the company appointed James O'Donnell as an independent director. In his message, Mr Elman said: "Jamie has been associated, on and off, with the Group in various guises for most of his life, in both its private and public personae." What a fine advertisement for someone who is supposed to be an independent director! In any case, "Jamie" lasted just over a month as an independent director as he resigned to become a special advisor on corporate strategy.

ROLE CONFLICTS

Meanwhile, somewhere along the way, Mr Brough became executive chairman. While Noble mentioned that Mr Brough "will take charge of reviewing strategic alternatives" – indicating a more involved role in the company – the company's announcement about the reconstitution of the board and committees only listed him as chairman. The fact that he had in fact become an executive chairman is disclosed in the company's website and in the corporate governance report published on Feb 28, 2018.

This raises yet more concerns as Mr Brough remains as audit committee (AC) chairman, which is of course contrary to the Singapore Code of Corporate Governance which recommends that the AC should be made up only of non-executive directors, with a majority and the chairman being independent. The company justifies this as follows: "In the present circumstances, as the Company endeavours to complete the restructuring, recruitment of a suitably qualified, experienced independent non-executive director to chair the audit committee is challenging."

Further, Mr Brough and Mr Elman make up a majority of the three-member Remuneration and Options Commit-

tee (ROC) chaired by independent director Christopher Dale Pratt. Again, this is contrary to the Code which recommends all non-executive directors, with the chairman and majority being independent.

The reasons given by the company regarding non-compliance with the Code for the AC and ROC do not address the risks of conflicts and open the company to criticisms about its accounting, disclosures and remuneration, as independent oversight is severely compromised. And indeed, all these areas have been questioned.

QUESTIONABLE REMUNERATION

In the case of remuneration, Mr Brough, Mr Elman and the CEO, William Randall, were together paid more than US\$15 million in the past year, with Mr Brough and Mr Elman involved in determining this. The company disclosed only unlimited top bands of "\$1.5 million and above" for each of them, as the company has always done. In the case of Mr Brough, 97 per cent of his remuneration is in fixed salary. This is perhaps expected as his main responsibilities were to lead the strategic review and the restructuring, not to manage the company.

With Mr Elman relinquishing his executive role in May 2017, he should be paid much less than in the past, but we only know that 34 per cent of his remuneration was in benefits. It is Mr Randall's remuneration that perhaps raises the most eyebrows here, as his bonus was 72 per cent of his total remuneration even as the company lurched from a profit of US\$8.1 million in FY2016 to a US\$4.9 billion loss in FY2017.

The company gave the usual excuses for the lack of transparency in remuneration including "the fact that many of the Company's competitors are private and do not publish remuneration information". In a recent remuneration report published by Chew Yi Hong and me, we found that companies that were less transparent in remuneration disclosures tended to pay higher remuneration amounts. We concluded that companies that are less transparent are more likely trying to hide excessive remuneration – perhaps to avoid outrage from minority shareholders.

In Noble's case, there is little risk of anyone trying to poach its management to run their companies, certainly not with the remuneration the company was paying. In fact, the greater risk may have been attracting executives who see the opportunity for getting outsized remuneration and generous severance packages.

Let's now look at the remuneration of the former co-CEO Jeff Frase, who left in November 2017, just 18 months after he was promoted to the position. His total package on departure of more than US\$20 million comprised US\$16.73 million in "other emoluments" and US\$3.46 million in "share-based payment expense". After SGX queried the "other emoluments", Noble gave a breakdown, which shows severance items such as "lump sum payment" of US\$3.80 million, "loan written off" of US\$3.82 million and "prior-year bonus released from clawback (non cash)" of US\$7.65 million.

We have no idea about the severance terms promised in Mr Frase's contract, but the loan write-off caught my attention. The financial statements have more to say on this: "During the year ended Dec 31, 2016, the Group had a loan of US\$5,000,000 and a temporary advance of US\$8,200,000 to two key management personnel. The temporary advance was interest-free and was repaid within one week. The loan bore interest at 0.43 per cent per annum and was due to be repaid in installments in 2017 and 2018. During the year ended Dec 31, 2017, the loan was forgiven." How nice ... for the two key management.

In response to SGX's query, Noble also said that "the banks had required the Company to pay US\$20 million in retention payments to senior NAC staff". I am not aware that banks would tell companies how much to pay in retention payments – I thought as creditors, they would just be concerned about companies paying too much! Perhaps what Noble really meant is that the

banks asked the company to retain the staff and the company decided that US\$20 million was what was needed.

Another indication that Noble may be extremely generous with its remuneration for senior management came earlier when news reports in June 2017 said that the former Noble CEO, Yusuf Alireza, who left in May 2016, had filed a lawsuit against Mr Elman in Hong Kong alleging breaches of contract. Mr Alireza was said to be seeking at least HK\$450 million (S\$75 million) in shares. According to the writ, he was promised about 63.9 million fully-paid shares in Noble for starting work at the company, and an additional 52.3 million shares when his employment was terminated, and those shares have not been transferred.

POOR GOVERNANCE AND TRANSPARENCY AROUND THE PROPOSED RESTRUCTURING

Today, Noble's board of directors is down to just seven directors, including three independent directors, one of whom has indicated that he will not be seeking re-election in the coming annual general meeting.

Recently, it was reported that Goldilocks Investment Company (Goldilocks), which owns just over 8 per cent of Noble, had requested for two board seats, but was declined by Noble for "corporate governance reasons". Frankly, this is laughable when one considers its poor corporate governance. While having too many directors who are representing substantial shareholders could weaken board governance, having some new directors who are not too close to management and the other directors, and who are not vested in what has gone on before, would have helped build trust in the proposed restructuring and the fairness of the RSA to all stakeholders.

The proposed restructuring is driven by management and a group of senior creditors. To further rub salt into the wound, Noble decided to discontinue having a lead independent director because "based on past experience, it is remote and unlikely that shareholders would be unable to relate or resolve their concerns through the normal channel of the chairman or CEO, or to communicate with the independent directors if they wished to do so". Really? I thought public stakeholders have been feeling rather left out and blindsided.

It is good that SGX has issued a notice of compliance to the company to appoint an independent financial advisor to provide an opinion on whether the proposed restructuring plan is fair and reasonable.

Compromise on the part of different stakeholders is necessary for a restructuring plan to succeed. Creditors with more senior claims will be expected to come off better. However, when the plan is developed between management and a group of senior creditors without consultation with others and oversight by an independent party with no vested interests, the terms will naturally be questioned, especially if it appears to strongly favour the parties who came up with it.

Under the proposed plan, the existing senior debt of US\$3.45 billion will be exchanged for US\$1.66 billion of new senior debt and 80 per cent of the equity of New Noble. Management and existing shareholders will each own 10 per cent. Management has an option to acquire 10 per cent of common equity from the senior creditors and will make half of this available to the then

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prevailing shareholders of New Noble. The aggregate exercise price for all the shares under the option will be US\$85 million payable in cash – this option is only valuable if New Noble achieves a value exceeding US\$850 million.

To further incentivise management, New Noble will grant management a one-off performance incentive share option to subscribe for a further 5 per cent of new common equity in New Noble. This option is subject to New Noble achieving an equity value of US\$2.1 billion, and when this is achieved, management will make 50 per cent of the incentive share option available to the then prevailing shareholders.

I would have thought a more equitable arrangement would see management given little or no shares now, and instead be remunerated with measured amounts of restricted shares and performance-based incentives vesting over several years to align their interests with other stakeholders. Without justification and with management being so closely involved in deciding how the New Noble pie will be shared, concerns about fairness are valid.

Holders of existing perpetual capital securities are asked to exchange their US\$400 million face value securities for "new US\$25 million 2.5 per cent non-cumulative pay-if-you-can" securities. Existing shareholders are asked to settle for 10 per cent equity stake in the new company – with some options thrown in, whose value depends on management performance (which is not comforting based on past experience).

Clearly, while dilution of existing perpetual security holders and existing shareholders would be expected, the proposed dilution is severe. Further, the company has said that if shareholders do not approve the restructuring, the restructuring "will be completed by moving the Group's centre of main interests to the United Kingdom, seeking the appointment of an English Administrator to sell all of the assets of the Company to New Noble".

In fact, the company said that the board has already agreed to commence this process, suggesting that it does not believe that shareholders will approve the plan. Noble also said that any shareholder which does not vote in favour shall not be entitled to receive any shares in the New Noble.

When all the above are taken together, public shareholders and holders of perpetual securities have every reason to feel oppressed. Substantial shareholder Goldilocks is fighting back. The investment company is suing Noble and its executives, including founder Richard Elman, in the Singapore High Court, alleging the trader inflated profits to raise money.

The suit also alleges management paid themselves inflated salaries, and then tried a cover-up when the accounts came under increased scrutiny, according to a copy of the case filed by Morgan Lewis Stamford LLC and seen by Bloomberg. As well as Mr Elman, the defendants include CEO Randall, chairman Brough, and chief financial officer Paul Jackaman.

TIME FOR ACCOUNTABILITY

I do not see any future for the New Noble, especially with the current management team remaining in place. It has destroyed considerable stakeholder value. Trust has been lost and will be very difficult to regain unless there is a complete overhaul in management, and a new and independent board installed.

It may well be that Noble is past the point of saving and liquidation is the only option. There is no point in throwing good money after bad in the New Noble if it is just going to be more of the same.

Finally, I believe that SGX and other regulators need to examine whether the disclosure and accounting practices of Noble, and the actions of directors and key officers, have complied with listing requirements, securities laws and other regulation. Investors and observers around the world are watching to see if our actions match our reputation.

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