

BP Boardroom Compensation 2001 - 2010 – a Case Study

Nader El-Sayed¹ and David Gwilliam²

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¹ Doctoral Researcher in Accountancy, Business School, University of Exeter – Streatham Court,
Rennes Drive, Exeter, UK, EX4 4PU. Email: nme203@exeter.ac.uk
Assistant Lecturer in Accountancy, Faculty of Commerce, Menofia University – Gamal Abd El-
Nasser Street, Shebin El-Kom, Menofia, Egypt. Email: neom80eg@yahoo.com

² Professor of Accounting, Business School, University of Exeter – Streatham Court, Rennes Drive,
Exeter, UK, EX4 4PU. Email: David.Gwilliam@exeter.ac.uk

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Nader El-Sayed (University of Exeter – Menofia University)
David Gwilliam (University of Exeter)

Abstract

Issues as to the suitability of executive compensation packages have obtained an ever increasing profile in recent years. Whilst there has been quite extensive quantitative investigation of relationships between compensation and performance there has been less focus on case study based analysis. This paper seeks to add to the relevant literature by means of a longitudinal case study of remuneration at BP – a major multinational oil company - over a ten year period. Within the context of a variety of theoretical and institutional perspectives the study investigates how boardroom executive remuneration in BP has been determined over the last ten years and speculates as to potential explanations for the outcomes uncovered. The primary methodology employed in the study was qualitative based on review of BP's annual reports in particular the Directors Remuneration Reports - but this was supplemented by content analysis utilising NVivo software.

The outcomes of the study suggest that it is difficult to find significant support for a pure agency theory approach whereby shareholders seek to align their interests with those of their managers as a driver of executive compensation packages. There is more evidence suggestive of a managerial power/hegemony perspective and also significant indicators of the importance of personal relationships and influence at boardroom level. The conclusions also reflect on the role of the remuneration committee and its nature as an institutional construct and considers whether it constrains, obscures, or adds pseudo legitimacy to boardroom compensation.

Key words

Executive Compensation, Remuneration Committee, BP case study

Introduction

In recent years issues as to board room compensation have been extensively aired in the popular media, the academic literature and periodically in the regulatory arena.³ In the UK the media has tended to focus on single high profile cases, for example in the 1990s the ‘fat cat’ controversy surrounding Cedric Brown’s remuneration at British Gas,⁴ the 2003 shareholder revolt at GlaxoSmithKline directed at Jean-Pierre Garnier’s compensation package,⁵ in 2008 the outcry associated with the revelation that Sir Fred Goodwin chief executive of the failed Royal Bank of Scotland would walk away at the age of 50 with a pension entitlement valued at anything up to £30m.⁶ In contrast the quite extensive academic literature, aspects of which are reviewed briefly below, has been dominated by studies which have sought to identify associations, causal or otherwise, between amount and nature of executive compensation and the performance of an entity – performance normally measured in terms of profitability and return but sometimes inclusive of wider stakeholder goals and objectives. With relatively few exceptions (as for example two interview based studies of remuneration in the UK, the first at two utility companies (Bender, 2003) while the second at twelve companies which had consummated significant changes to its board compensation over a period of a few years (Bender, 2007)) there has been far less focus on case study analysis of actual remuneration within specific companies.

The purpose of this paper is to provide such a case study by reference to boardroom remuneration at BP, one of the largest UK quoted companies, in the years between 2001 and 2010 - of course a period within of the blow out on the Deepwater Horizon rig in April 2010 and the ensuing massive oil-spill in the Gulf of Mexico which

³ See for instance, the recent report of the ‘High Pay Commission’ available at:

<http://highpaycommission.co.uk/wp-content/uploads/2011/09/HPC-DPperformance.pdf>

Another example, The economist report under the title of ‘Executive Pay: Money for nothing’ available at:

<http://www.economist.com/node/21542802?fsrc=scn%2Ftw%2Fte%2Far%2Fmoneyfornothing%0A%0A%0AThank>

⁴ See, the Independent report:

<http://www.independent.co.uk/life-style/cedric-brown-fat-cat-in-the-dog-house-1611078.html>

⁵ See, the New York Times report:

<http://query.nytimes.com/gst/fullpage.html?res=9804EFD9133EF933A15756C0A9659C8B63>

⁶ See, the Telegraph report: <http://www.telegraph.co.uk/finance/personalfinance/pensions/4861923/Sir-Fred-Goodwin-True-cost-of-pension-is-30m.html>. In January 2012, Fred Goodwin was stripped of his knighthood.

pushed BP headlong into the forefront of media and political attention in the UK, USA and worldwide – albeit a time during which BP experienced turbulence both in respect to its safety and environmental profile, its relationships with its investors, and the composition of its senior management team.

BP is an interesting research site for a number of reasons: these include the fluctuating levels of executive director compensation over the period under review, the board room tensions re the timing of the retirement of a dominant chief executive⁷ and the ambitions of younger directors to replace him⁸, the international nature of its operations and the presence of both UK and US directors on the board, the role of longstanding and powerful non-executive directors. There is also evidence of periodic shareholder disquiet as to the level of executive director compensation culminating in the 38% of shareholders who voted against the remuneration committee's report at the Annual General Meeting held in April 2010. An archival based case study of this type supported by content analysis cannot necessarily champion or establish beyond argument any one particular theory as to the manner in which executive director remuneration is established – but it is contended that it can offer a range of insights into the process whereby it is established and into the factors and competing pressures which underlie the process and drive the outcomes.

The paper is organised as follows. After this short introduction the first main section introduces a number of the theoretical perspectives underlying the question of how boardroom and senior executive remuneration are or perhaps 'should be' set, together with a review of the academic literature thereon referred to above. It also refers briefly to institutional and regulatory aspects in terms of approval, disclosure and governance requirements as, for example, set out in Companies Act and the Combined Code (now the Governance Code) in the UK. The second section reviews the nature of remuneration practice at BP with a particular focus on the years 2001-2010 although at times there is reference to earlier developments. This section details changes in the amount and nature of remuneration packages over the years under examination and explores the role of the remuneration committee in effectively

⁷ Lord (Edmund John) Browne who resigned at 59 years old after dominating the CEO position for about 12 years by the beginning of 2007.

⁸ Doctor Anthony (Tony) Bryan Hayward became the BP CEO in 2007 until now.

determining the type and extent of those packages. The third section provides a more specific empirical analysis of the Directors Remuneration Reports utilising NVivo: Qualitative Analysis Software⁹. The final section provides an overall review, reflects on what it is possible to learn from the information contained in the case study, and speculates as to potential explanations for the outcomes uncovered.

1. Background and Theoretical Perspectives

There are a myriad of theories which have been developed - either as normative models of how executive pay should be determined or as explanatory models of how executive compensation is actually determined – although frequently the distinction between the normative and the descriptive is blurred. Rather than seek to rehearse this very extensive literature again in detail in this paper we shall focus mainly on two aspects of theory which may be seen as in part at least competing, agency theory and managerial hegemony theory before making brief reference to other behavioural strands of ‘theory’ which may be powerful in explaining the actuality of practice.

The traditional perspective on the nature of commercial enterprise was that it was organised on the basis of individuals, or groups of individuals acting together, who provided the capital, undertook the risk and managed the day to day operation of the business. Successful enterprise and management might result in the accumulation of enormous wealth,¹⁰ unsuccessful enterprise and management could lead to the debtors prison or, in fiction at least, death on the tracks at Tenway Junction.¹¹ Inevitably this is a partial perspective as in the real world the achievement or grant of monopoly rights, political patronage etc were frequently drivers of the rewards achieved - and also even the early joint stock companies would have managers, or their equivalent, who would work together with those responsible for the provision of capital to oversee the running of the business (Scott, 1910).

⁹ NVivo is a powerful data analysis program produced by QSR International which guides the researcher from questions to answers throughout organising and analysing the information, and exploring and visualising the outcomes (<http://www.qsrinternational.com>). Over the period under examination NVivo utilizes to identify and gather the selected terms (i.e. nodes), code terms of interest, and examine coded terms by using a set of analytical techniques.

¹⁰ As for example in the case of John Gladstone, father of the future Prime Minister, the second of sixteen children who coming from a relatively modest Scottish background accumulated a very substantial fortune from trading in corn, cotton and sugar with the Americas and his plantation interests in the West Indies..

¹¹ For example: the fate of Ferdinand Lopez in Anthony Trollope’s novel of the period ‘The Prime Minister’.

However it was not until the twentieth century that there was recognition of the significant incremental change that had taken place in the arrangements between owners and professional managers, recognition most famously illustrated in Berle and Means' book published in 1932. Since that date the relevance and importance of a managerial class, with incentives not necessarily derived from the ownership of a significant equity stake in the enterprise for which they work, has come to dominate much of the organisational and management literature. Within this literature an important theme has been the appropriate means to remunerate this managerial elite for the purpose of aligning their interests with those of the owners of the equity capital – interests normally seen in terms of maximising financial returns to the shareholders. In this context the 'agency theory' paradigm as formalised in a number of papers from the 1970s onwards, perhaps most notably that of Jensen and Meckling, has been highly influential. In its simplest form agency theory provides a framework to examine the manner in which 'principals' (the equity shareholders) might seek to control and incentivise 'agents' (the managers) to work in their best interests in circumstances where the managers have information available to them, for example as to actual or likely outcomes of investment choice, information which is not so easily available to the shareholders. At a risk of oversimplification agency theory perspectives suggest that principals have the ability to achieve appropriate incentivisation by means of suitably drawn contracts, contracts which are likely to include a mixture of direct and contingent compensation (contingent either upon the achievement of targets or share price behaviour) and are accompanied by monitoring procedures as to the fulfilment of those contracts, for example audit or direct or indirect board representation. One strand of agency theory suggests that in a rational expectations type world 'good' managers will in fact voluntarily sign up to such forms of monitoring so as to demonstrate their bona fides vis-à-vis 'bad' managers. Although generalisations across a wide field are fraught with difficulty it is probably fair to characterise the majority of agency theorists as being supportive of the power of the markets and in the context of executive remuneration antithetical to intervention which might affect and distort the market process – although this perspective has given rise to those more critical of the paradigm (e.g. Tinker, 1988) suggesting that agency theory is in essence little more than a Panglossian apologia for the status quo.

However a separate strand of theory/explication suggests that in a real world of uncertainty and highly imperfect information, and one which is not necessarily characterised by a myriad of individual agents operating within a rational expectations framework, the institutional and organisational structures are such that managers have the ability to dominate and control the operations of the entity that they manage and, as an adjunct to this, largely determine their own remuneration contracts. Principals of inefficient companies may have residual powers in terms of an ability to sell their holdings to other companies – in which case the incumbent management is unlikely to remain in situ – but this is a blunt and uncertain power and frequently managerial contracts are written to ensure significant compensation in the event of loss of office.

More recently the research focus has shifted - or perhaps come back in a circle - toward an emphasis on personal contact and relationships within organisations. The last few years has seen an explosion in what is termed social network theory (Jones et al., 1997)¹² which focuses directly on these relationships – and although this paper is not structured specifically in terms of networking theory nevertheless we do bring out a number of links and connections which might be seen as relevant in the context of the material under examination. We also make reference to the wider behavioural literature which focuses on the importance of structure, personal and psychological relationships and at times economic irrationality in determining behaviour and outcomes within organisations.

1.1 Institutional and Regulatory Frameworks

Until the 1980s the institutional framework surrounding executive remuneration in the UK was all but vestigial. Other than a long standing Companies Act requirement, for the amount paid to the chairman and to the highest paid director (if not the chairman) to be disclosed together with disclosure of the number of employees in income bands above a certain level there were no disclosure requirements nor was there any requirement for disclosure of options or other similar contingent remuneration. Over time the Stock Exchange began to require more disclosure in respect to directors’

¹² The Social Network Theory reprinted in Clarke 2004, Huse British Journal of Management 2005, Kirchmaier and Stath LSE 2008 (see: Managerial Power Perspective in Bebchuk and Cohen 2003, Bebchuk and Fried 2003).

remuneration in quoted companies and as concerns as to the existence of rolling contracts, non-disclosure of contingent payments, pension obligations as well as the overall scale of remuneration rose, the Greenbury Committee was set up and reported in 1995. It recommended that companies should have a remuneration committee consisting entirely on non-executive directors, that some element of executive director remuneration should relate to long term performance, and that contracts should not exceed twelve months in duration. Three years later the Hampel Committee recommendations fed through into the revised Combined Code published in 1998, the listing requirements of the Financial Services Authority and also more directly into statute in the Directors' Remuneration Report Regulations 2002 which extended the disclosure requirements for quoted companies - and required an (advisory) vote on the suitability of the directors remuneration report at the annual general meeting (Deloitte 2004). Further governance recommendations were contained in the Higgs Report 2003 and these were incorporated into subsequent revisions of the Combined Code. Beyond this other stakeholders including the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF) published guidance in 2009 and 2011 respectively as to how shareholders should evaluate the quality of the remuneration report for the purpose of deciding on voting behaviour.¹³ Currently disclosure requirements in respect to directors' remuneration for UK quoted companies are governed by the Companies Act 2006 which has incorporated the 2002 requirements, the Financial Service Authority's listing rules – in particular in respect to the approval of share plans by shareholders, the Combined Code (now the UK Governance Code) – in particular in respect to the role of the remuneration committee and the design of performance related remuneration, and more indirectly by the guidelines of UK institutional investor bodies.

2. BP Case Study

BP began life in 1909 as the Anglo-Persian oil company after a near ten years search for oil in Persia (modern day 'Iran') largely at the instigation of a wealthy UK private individual (who had received a sixty year concession over oil rights in Persia from the then Shah) After early difficulties it began to prosper in World War 1 (with injections

¹³ In particular, those of the Association of British Insurers (ABI) "Executive Remuneration – ABI Guidelines on Policies and Practices" - 2009, and the National Association of Pension Funds (NAPF) "Corporate Governance Policy and Voting Guidelines" - 2011.

of capital from the British government to support its contract to fuel the Royal Navy) and acquired the UK assets of 'British Petroleum' - a German company which used the name for distribution purposes in the UK and whose UK assets were expropriated during the war. The company continued to flourish during the inter war years as the use of motor vehicles became more widespread. It discovered a major oil field in Iraq (in Kirkuk) in 1927 and in 1933 reached a compromise agreement with the government of Persia over the renegotiation of the original concession - albeit one which was still highly advantageous to the company ahead of a change of name to Anglo-Iranian in 1936. World War 2 - and quasi nationalisation of oil supply and distribution in the UK - was less kind to the company but post war recovery brought growth and expansion overseas although in 1951 a significant setback occurred with the nationalisation of its Iranian oil operations. Although a CIA inspired coup returned a significant stake to the company the writing was on the wall with regard to its Middle East interests as over the next twenty years the rise of Arab nationalism resulted in a rapid fall in the proportion of the newly renamed British Petroleum's revenues deriving from the region.

Without its ready made supply of easy to drill Arabian oil (although Abu Dhabi continued to be a significant source) BP¹⁴ was forced to look elsewhere and in the 1960s the company spread its exploration activities successfully around the world, for example in Nigeria, the North Sea and in Alaska where, in 1968, after a decade of drilling dry wells along the North Slope, BP was on the verge of abandoning its search before, as in Persia sixty years earlier, a last chance drilling operation was successful. By the end of the century BP had further developed its access to oil undertaking major joint venture projects in Russia and former Russian states, as well as successfully prospecting offshore in the Gulf of Mexico.

Meantime to assist its distribution of Alaskan oil in the US BP acquired 25% of Standard Oil of Ohio (SOHIO) and in 1987 purchased the company outright. This was followed by the key note 'merger' in 1998 with AMOCO (a former competitor in Iran) and a further significant 'merger' with ARCO another US producer together with a number of other smaller deals. The driving force behind the acquisition

¹⁴ The British Petroleum Company used the title BP in much of its marketing and other literature until the formal change of name to BP Amoco in 1999 and then to BP in 2001.

strategy of the late 1990s was John Browne (Lord Browne) - a lifelong BP employee - appointed CEO in 1995 and who remained in that position until his resignation in 2007. Lord Browne was also credited with building on the work of his two immediate predecessors, Bob Horton and David Simon (Lord Simon) in streamlining BP's work force and introducing much greater performance accountability throughout the company (Roberts, 2005).¹⁵ Throughout much of its corporate life – and for the entirety of the period under review - the main source of profitability for BP has been what it terms its upstream operations - essentially exploration and production - with much smaller contributions coming from refining and distribution and typically still less from the variety of non-core businesses including chemicals and more recently alternative energy.

Over time the ownership of BP changed significantly - the early shareholdings reflected the initial proprietorial interest together with support from the older established Burmah Oil¹⁶. However in 1914 the UK government took a controlling stake in BP (and which at times exceeded 50%) – which it did not finally relinquish until the privatisations of 1979 and 1987. Today BP, and throughout the period under examination, has a mixture of institutional and private shareholders – including a very significant proportion of overseas investors, many of them US investors acquired at the time of the ‘mergers’ with AMOCO and ARCO at the end of the twentieth century.¹⁷ In recent years BP has been noted both for its strong cash flow and high dividend yield although, as discussed further below, even ahead of DeepwaterHorizon its shares had for many years failed to outperform the main UK market indices.¹⁸

¹⁵ See: “Organising for performance: How BP did it”, John Roberts 2004 Stanford Business Magazine (February, 2005) available at: http://www.gsb.stanford.edu/news/bmag/sbsm0502/feature_bp.shtml

¹⁶ In 2000 BP - by then much the bigger of the two - reversed the roles by taking over Burmah Castrol.

¹⁷ Further details to the early history of BP can be found in The history of the British Petroleum Company:

- Vol. I: R. W. Ferrier, *The Developing Years 1901-1932*, Cambridge University Press, 1982.
- Vol. II: James H. Bamberg, *The Anglo-Iranian Years, 1928-1954*, Cambridge University Press, 1994
- Vol. III: James H. Bamberg, *British Petroleum and Global Oil, 1951-1975: The Challenge of Nationalism*, Cambridge University Press, 2000

For the early history of BP in Iran and Iraq, See:

Karl E. Meyer and Shareen B. Brysac, *Kingmakers: the Invention of the Modern Middle East*, W.W. Norton, 2008. ISBN 978-0-393-06199-4

A brief abstract available at: <http://www.wwnorton.co.uk/book.html?id=1787>

¹⁸ BP share price which was 555p at the start of 2001 had in fact fallen to 475p by end 2010. Check: <http://production.investis.com/bp2/download/uk/>

2.1 Reports' Disclosure

Throughout the period under review the BP annual report contained specific information as to both governance (from 2004 the 'Governance: board performance report' and later just the 'BP board performance report') and remuneration of directors (from 2002 the 'Directors' remuneration report'). The basic material for much of this case study is derived from these reports – in particular the Directors' remuneration reports – although other information contained in the annual reports is also reviewed and referred to where appropriate together with information obtained from internet or other sources.¹⁹

2.2 Board Structure

In the period covered by this study although the size of the board of directors remained reasonably stable there were significant changes in the personnel comprising that board. At end 2001²⁰ there were eighteen directors, six executive and twelve non-executive; whereas at end 2010 there were fifteen directors, three executive and twelve non-executive. However only one executive director (Byron Grote who had been appointed in 2000) and two non-executives (Peter Sutherland the chairman from 1997 who stood down at the end of 2009 and Ian Prosser who had been deputy chairman from 1999) were in situ throughout.²¹ Perhaps the most significant change had been the retirement, after a widely reported boardroom battle and hastened by publicity associated with his personal life, of the CEO Lord Browne in 2007 and his replacement as CEO by his erstwhile protégé Andy Hayward who had joined the Board in 2003.

2.3 Executive Directors' Remuneration Packages

Throughout the period under examination the composition of the remuneration packages available to executive directors remained broadly similar comprising: a

Over this period the FTSE 100 decreased from 6198.1 to 5899.9. Check:

<http://uk.finance.yahoo.com/echarts?s=%5EFTSE#symbol=^ftse;range=20001127,20120218;compare;indicator=volume;charttype=area;crosshair=on;ohlcvvalues=0;logscale=off;source=undefined>

¹⁹ The length of the Annual Report grew from 38 pages in 2001 to 251 pages in 2010. The Directors' Remuneration Report, or equivalent, expanded from 5 pages in 2001 to 12 pages in 2010.

²⁰ The BP Annual Report is normally published in February of the year following the calendar year to which it relates. In this paper year references are to the year covered by the report not its date of publication.

²¹ Sutherland would presumably not have participated directly in the board meetings immediately ahead of the 2009 Annual Report and Annual General Meeting

basic salary, an annual performance bonus payable in cash, fully paid shares under longer term incentive plans ‘performance shares’, and for part of the period ‘share options’ dependent upon the achievement of performance targets - a pattern which, with variations thereon, is common across the great majority of large UK quoted companies. In addition over the period all executive directors participated in pension schemes - some received resettlement or accommodation allowances and there were occasional (but not insignificant) one-off payments to directors under the heading ‘retention allowances’. The determination of the criteria under these headings to be used in assessing the amount of remuneration to be received by individual directors, throughout the period, was the responsibility of the ‘remuneration committee’, a board committee consisting entirely of non-executive directors - whose recommendations are subject to the approval by the full board and ultimately by the shareholder body. As noted above - and below - there has been quite extensive criticism in some years of these recommendations, but in no year under consideration did the shareholders not approve the proposals put before them.

In Appendix 1 Panel A shows the disclosed remuneration of the BP executive directors (including the CEO) in post at the end of each calendar year between 2001 and 2010 under the headings of annual salary, bonus, pension, other cash payments and the grant of fully paid performance related shares as well as share options at market price. Panel B (also in Appendix 1) presents the disclosed remuneration of the CEO under the same headings. The figures are derived from BoardEx data base and it is not that easy to reconcile these numbers with those contained within the company annual reports - particularly those in respect to the Long Term Incentive Plan. They do however contain valuations of the options which are not easy to obtain from the annual reports, although values were calculated by BP based on a Black and Scholes model for the purpose of relating the proportion of pay which was directly linked to performance. The figures are heavily influenced by the changing pattern of board composition as new directors came onto the board, for instance the replacement in the early years of the decade of Ford (retired in 2002), Buchanan (2002), Chase (2003), Olver (2004) and finally in 2007 Lord Browne, by the younger generation of Grote (appointed in 2000), Allen, Hayward, Manzoni (all appointed in 2003), Conn (2004),

and Inglis²² (2007, who resigned in 2010 as well as Hayward) which initially resulted in lower basic salary payments for the incoming directors. They also show the domination in terms of relative remuneration by Lord Browne over the period 2001-2006 and the significant increases in terms of both salary and bonus achieved in 2007 by the other directors following Lord Browne's departure in that year – most notably by the new CEO Andy Hayward – and which together with the one-off retention awards of £1.5m shares made to both Conn and Inglis in February 2008 compensated for the non-award of any performance shares in this year. These increases accelerated in 2008 together with the return of performance share awards, albeit at modest levels relative to those in previous years, and continued propelled by enhanced bonus and performance share awards in 2009 – and in this year for the first time, the compensation package of Andy Hayward in respect to salary and bonus matched that of Lord Browne in the earlier part of the decade – although it still lagged significantly behind in terms of performance shares and share options. In 2010 – consequent to Deepwater Horizon – there were, with minor exceptions, no rises in salary or bonuses for the executive directors. There were also significant boardroom changes with both Hayward and Inglis leaving the board and the appointment of Dudley as CEO.

The following sub-sections detail the manner of development over the period under the respective headings of: salary, annual bonus, long term incentives, performance shares, share options, pensions, other remuneration, as well as non-executive directorship.

2.3.1 Base Salary

Salaries for executive directors were significantly increased in 2001:

*'Taking into account this advice and the fact that base salaries had not previously been increased since October 1999, the committee decided to increase Lord Browne's salary by 47% and the other executive directors' salaries by an average of 15% for 2001.'*²³

²² Manzoni – who had been seen as a contender for the position of CEO left the board in 2007, and Allen – a close associate of Lord Browne left in 2008. The only other change in the executive directors in the period under examination occurred in 2009 when Robert Dudley, who had previously been the managing director of the joint venture with TNK, joined the board. In 2010, following the Deepwater Horizon catastrophe and its aftermath, Andy Hayward stepped down and was replaced by Dudley and not long after Inglis head of exploration and production left the board.

²³ Annual Report, (2001), p.36

Changes in future years reflected both the generational shift in the composition of the board and also changes in job description – but on an individual basis saw significant increases across the period under examination. The only executive director in post throughout (Grote) saw his base salary more than double from \$665,000 in 2001 to \$1,380,000 in 2009 and 2010 too. In 2003 Allen, Hayward and Manzoni all received a base salary of £367,000. By 2006 - the year before the board room changes of 2007 - their salaries had risen to £463,000 for each individual. Conn who received £400,000 pro rata in 2004 saw his basic salary rise to £690,000 in 2009 and 2010 too. In 2009 Hayward's salary had risen to £1,045,000, although he had of course stepped up to be the CEO in 2007 (and in fact his basic salary was still below the £1,531,000 received by Lord Browne in 2006 – in 2007, Lord Browne also received an ex gratia payment equivalent to one year's salary of £1,575,000). In 2010 Hayward's salary received £958,000 as a last fixed sum before leaving the board, as well as Dudley's salary rose to \$1,175,000 compared with his start in 2009 by \$750,000 due to his role as group chief executive at the end of the year. However Dudley's salary had been reported as \$1,000,000 in 2009 and \$1,700,000 in 2010 by adding the amount of non-cash benefits and other emoluments.²⁴

These increases in salaries were well in excess of any form of match with UK inflation or earnings indices for the relevant period – and ahead, albeit by rather less, of average increases in remuneration of the BP work force.²⁵ Furthermore they are important in that they form the baseline for the annual cash bonus payable subject to the achievement of the targets – and as these targets were routinely achieved - then the increasing level of base salary effectively acted as a multiplier to the annual bonus received. They also form the base for the calculation of the number of performance shares that might be awarded - as is discussed further below.

2.3.2 Annual Bonus

The nature of bonuses - which in general more than doubled the basic salary payments in every year - are investigated by means of review of the amounts awarded and the

²⁴ Annual Report, (2009), p.84; and Annual Report, (2010), p.114

²⁵ Calculation of the increase in pay for BP employees is complicated both because the numbers are reported in dollars and affected by exchange rate movements and also the significant shrinkage and change in composition of the work force over the period.

criteria for those awards as set out in the relevant directors' remuneration reports. Salient features of change over the period were an increase in the percentage of base salary which could be awarded - in 2001 it was 100% (110% for the CEO) going up to 150% in exceptional circumstances, in 2005 it rose to 120% (130% for the CEO), and remained at that level thereafter although the 150% ceiling remained (except it had risen to 165% for the CEO). Throughout the remuneration committee discretion has been claimed to award higher or lower bonuses than those achieved according to the targets. The extent to which this discretion was exercised in any year is not that clear although it would appear that normally it moved the numbers up with the salient exception of 2006, the only year for which the bonus in aggregate did not match base salary, where there was a significant reduction:

*'While the quantitative assessment generated a near-target score, the remuneration committee also considered broader qualitative factors. These included the findings of internal and external reports on operational and safety issues in the US business. On balance, the committee judged that bonus levels should be reduced by 50% from the level they would otherwise have been.'*²⁶

In addition the annual bonus amounted to only just over 50%. However this was very much a one-off and by 2009 bonuses amounted to approximately 170% (and 200% for the CEO) well above the specified normal maximum.

The proposed targets themselves also changed across the individual years although maintaining a mix of financial and non-financial targets throughout - and the amount of detail given as to the nature of the targets and feedback on their achievement increased significantly and all (but monotonically) over the period under review. In respect to targets for 2002 there is just reference to 'a mix of financial targets and leadership objectives'. For 2003 slightly more detail was provided:

*'Executive directors' annual bonus awards for 2003 will again be based on a mix of demanding financial targets and other leadership objectives, established at the beginning of the year. In addition to business performance, they cover areas such as people, safety, environment and organization.'*²⁷

In 2004 there was no significant change – but rather more detail was provided as to what constituted good performance:

²⁶ Annual Report, (2006), p.69

²⁷ Annual Report, (2002), p.34

‘Executive directors’ annual bonus awards for 2004 will be based on a mix of demanding financial targets relating to the company’s annual plan and leadership objectives established at the beginning of the year. In addition to stretching milestones and long-run metrics to track the enactment of strategy, they include areas such as people, safety, environment and organization.’²⁸

For 2005 more information was provided as to the breakdown of the targets:

‘Executive directors’ annual bonus awards for 2005 will be based on a mix of demanding financial targets, based on the company’s annual plan and leadership objectives established at the beginning of the year, in accordance with the following weightings:

- *50% financial measures from the annual plan principally on cash flow.*
- *30% annual strategic metrics and milestones taken from the five-year group business plan. There is a wide range of measures, including those relating to people, safety, environment, technology and organization, as well as operational actions and business development.*
- *20% individual performance against leadership objectives and living the values of the group which incorporates BP’s code of conduct.’²⁹*

Although the breakdown between financial and non-financial remained the same for 2006, there was a significant shift away from cash flow toward the accounting data in terms of the financial metrics:

‘Executive directors’ annual bonus awards for 2006 will be based on a mix of demanding financial targets, based on the company’s annual plan and leadership objectives established at the beginning of the year, in accordance with the following weightings:

- *50% financial and operational metrics from the annual plan, principally earnings before interest, tax, depreciation and amortization (EBITDA) and return on average capital employed (ROACE).*
- *30% annual strategic milestones taken from the five-year group business plan, including those relating to technology, operational actions and business development.*
- *20% individual performance against leadership objectives and living the values of the group, which incorporates BP’s code of conduct.’³⁰*

There was no significant change for 2007 (although ‘cash costs’ were reinstated together with EBITDA and ROACE as an identified financial metric), or for 2008 other than slight reductions in the weighting for financial data and individual performance:

‘Bonus for 2008 will reflect the business priorities of safety, people and performance as articulated by Dr Hayward. Of the 120% ‘on-target’ bonus, 50

²⁸ Annual Report, (2003), p.109

²⁹ Annual Report, (2004), p.120

³⁰ Annual Report, (2005), p.165

*will be measured on financial results, principally earnings before interest, taxes, depreciation and amortization (EBITDA), return on average capital employed and cash flow; 25 will be based on safety as assessed by the safety, ethics and environment assurance committee (SEEC); 25 on people, behaviour and values; and 20 on individual performance, which will primarily reflect relevant operating results and leadership.*³¹

For 2009 there was further individualization:

*'The group chief executive's and group chief financial officer's bonuses will be based 70% on group performance against key metrics in the annual plan, 15% on safety performance and 15% on people. The chief executives of Exploration and Production and Refining and Marketing will have 50% of their bonuses determined on the above basis and 50% on the performance of their respective businesses.'*³²

For 2010 more radical changes were proposed with an increase in the proposed uplift levels (150% on target and maximum of 225% of salary)³³ but with one third payable in deferred shares and subject to assessment of safety and environmental performance over the three year period.³⁴

For 2011 information was unchanged other than focusing more on a number of corporate performance metrics - particularly in both the short and long term:

'The approach for 2011 aligns closely with the group template for reinforcing safety and risk management, rebuilding trust and reinforcing value creation. There is a balance of long-term and near-term objectives weighted towards the top priorities of risk identification and management, safety and compliance, and talent and capability development. Group measures for executive directors will focus on:

- Safety and operational risk metrics – including full implementation of the S&OR functional model.*
- Short-term performance – including key financial and operating metrics.*
- Long-term performance – including progress on key projects and reserves replacement.*
- People – including a new performance and reward framework.'*³⁵

Progressively over the period more details were given as to the proposed targets and also as to the outcomes relating to those targets. Space does not permit a full rehearsal

³¹ Annual Report, (2007), p.64

³² Annual Report, (2008), p.79

³³ Annual Report, (2009), p.85

³⁴ Together with an option to defer a further third

³⁵ Annual Report, (2010), p.114

of these disclosures, but there is a clear contrast between that relating to the 2001 bonus which in its entirety consisted of:

‘Executive directors’ annual bonus awards for 2001 were based on a mix of financial targets and leadership objectives established at the beginning of the year. Assessment of all the targets showed that, compared with a target performance of 100 points, 135 points were achieved, resulting in bonus awards as shown in the summary of remuneration on page 32.’³⁶

and that regarding the 2009 bonus:

‘The annual bonus awards for 2009 reflect the excellent performance achieved across the business and are set out in the table on page 83.

Performance measures and targets were set at the beginning of the year based on the group’s annual plan. Group results formed the basis for Dr Hayward’s, Mr Dudley’s and Dr Grote’s annual bonus and were weighted 70% on financial and operating results (including profit, cash flow, cash costs, production, reserves replacement, Refining and Marketing profitability, refining availability, and installed wind capacity), 15% on safety (both metrics and progress on plans), and 15% on people (including organizational changes and employee attitudes). Mr Conn’s and Mr Inglis’s annual bonuses were based 50% on the group results as above, and 50% on their respective business unit results (also a mix of financial, operating, safety and people measures). The target level of bonus for executive directors was 120% of salary with committee judgement to award up to 150% for exceeding targets and above that level to recognize exceptional performance.

Targets were exceeded on virtually all key measures during 2009, a number by a substantial margin and resulting in bonuses averaging 170% of salary. ...’³⁷

And this is illustrated further in the 2010 report where separate disclosures as to the annual and deferred bonuses included the following:

‘Annual bonus

The 2010 annual bonus results were dramatically affected by the Gulf of Mexico accident. ... As indicated in the table on page 112, no bonus was paid to Mr Dudley, Dr Hayward or Mr Inglis for 2010. Mr Conn and Dr Grote similarly received no bonus for their group portion and were limited to an ‘on-target’ level for their segment/functional portion (accounting for 30% of their overall bonus opportunity). ...

The total bonus to Mr Conn was £310,500 and to Dr Grote \$621,000. Of the total for each, one-third is paid in cash, one-third is deferred on a mandatory basis and one-third is paid either in cash or voluntarily deferred at the individual’s discretion. These amounts are shown in the table on page 112.

Deferred bonus

³⁶ Annual Report, (2001), p.36

³⁷ Annual Report, (2009), p.84

One-third of the bonus awarded to Dr Grote and Mr Conn is deferred into shares on a mandatory basis under the terms of the deferred bonus element. Their deferred shares are matched on a one-for-one basis and will vest in three years contingent on an assessment of safety and environmental sustainability over the three-year deferral period. ...

All deferred bonuses are converted to shares based on an average price of BP shares over the three days following the company's announcement of 2010 results (£4.84/share, \$46.68/ADS).³⁸

2.3.3 Long Term Incentives

Throughout the period under examination the base salary and annual bonus were paid wholly in cash. However, as noted above, there were longer term share based incentive plans in operation throughout. The Executive Directors' Long Term Incentive Plan (EDLTIP),³⁹ which was approved by shareholders in April 2000, included the potential for the award of fully paid shares, share options, or cash. Through until 2010 the main component has been the award of fully paid shares based on the achievement of performance targets over a three-year rolling period, ending at the close of the relevant year. These shares would not vest for another three years but - although there were provisions for discretion to be exercised in the vesting, no subsequent performance targets were set.⁴⁰ In 2001 through to 2004 share options granted at market price were also important and nearly 10m options were granted - but in 2004 the remuneration committee stated that they did not intend to use the grant of share options in future periods - and with the exception of small numbers flowing through from previous schemes, none have been awarded since. Nor have there been any direct cash awards.

Successful performance against the targets set gave rise to the potential for very significant rewards beyond the annual salary and bonus. In 2001 awards of £10.8m were made⁴¹.⁴² In 2002 they were £3.2m, in 2003 £3.5m, in 2004 £4.7m, in 2005 £8.0m, and in 2006 £4.9m. However in 2007 there was only an award of £0.4m to a

³⁸ Annual Report, (2010), p.114

³⁹ The acronym was later shortened to EDIP.

⁴⁰ There is no evidence of any awards once made been subsequently reduced.

⁴¹ In 2001 only the number of shares awarded to each individual director was disclosed, but the comparative value figures were disclosed in 2002.

⁴² The value calculations are based upon straight multiplication of the number of shares and their then market value - no adjustment appears to have been made in respect to the three-year vesting period.

director who had left during the year (Lord Browne)⁴³ and - although the awards were on an upward trajectory in 2008 £1.4m and 2009 £2.5m, they were still well below the levels achieved in the first half of the decade. Nor there have been any EDIP awards in 2010.

In terms of share options, approximately 2.2m were granted in 2001 (more than half of them to Lord Browne), 2.1m in 2002 (more than 60% to Lord Browne), 2.7m in 2003 (all but 50% to Lord Browne), 2.7m in 2004 (more than 50% to Lord Browne), after which - as noted above - the use of share options within the reward package was discontinued and has not been reinstated.

2.3.4 Performance Shares

Within the LTIP framework, performance shares were - and are - intended to provide the opportunity for executive to obtain very significant additional remuneration for strong performance. The potential number of shares to be awarded has throughout been based on multipliers of salary. No specific detail as to these multipliers was provided in 2001, 2002 and 2003 - in 2001 there was disclosure of the maximum number of shares per director that could be awarded under the commencing plan (2002-2004), but the equivalent information was not provided in 2002 or 2003. It was not until the 2004 Annual Report that full detail regarding the maximum (subject to the exercise of discretion by the remuneration committee) future awards available under the 2005-2007 scheme was provided.

*'The maximum number of performance shares that may be awarded to an executive director in any one year will be determined at the discretion of the remuneration committee and will not normally exceed 5.5 x base salary and, in the case of the group chief executive, 7.5 x base salary'*⁴⁴

The same formula was used in 2005, 2006 and presumably in 2007 - although it is not specifically referred to. In 2008 there is reference to a maximum of 5.5 x base salary for any executive director without any special reference to the CEO - but it is clear from the change in 2009 (to reflect the greater weight being given to the annual bonus) that his differential had been maintained:

⁴³ This was based on the wind down of a previous incentive plan.

⁴⁴ Annual Report, (2004), p.120

*'The share element of the EDIP has been a feature of the plan, with some modifications, since its inception in 2000. To reflect the introduction of the deferred matching element, the maximum number of shares that can be awarded will be reduced from 7.5 times salary to 5.5 times salary for the group chief executive and from 5.5 times salary to 4.75 times salary for the chief executive of Exploration and Production, and to four times salary for the other executive directors.'*⁴⁵

In 2010 no significant change provided other than the maximum number of shares awarded to the chief executive of Exploration and Production was unmentioned.

Over the period, targets set for the award of performance shares focused largely - but not entirely - on comparisons with other oil and gas companies. In 2001 reporting on the outcome of the 1998-2000 plan, it was noted:

*'The share element compares BP's performance against oil majors over three years, on a rolling basis. This has been assessed in terms of a three-year shareholder return against the market (SHRAM), return on average capital employed (ROACE) and earnings per share (EPS) growth.'*⁴⁶

For the 1998-2000 plan, the award for which was made in 2001 - the comparators were Chevron, Texaco, ExxonMobil, Shell and TotalFinaElf - and this was the case for the 1999-2001 plan as well for which an award was recommended in 2001. For the 2000-2002 and 2003 plan, the comparator group was ExxonMobil, Shell, TotalFinaElf, ChevronTexaco, ENI and Repsol-YPF. But in 2001, it was decided to change the comparator base for 2002-2004 plan:

*'The comparator group of companies used for the SHRAM performance condition in the share element has been reduced so much by industry consolidation that the committee has decided for the 2002-2004 Plan to change to the FTSE All World Oil and Gas Index weighted by market capitalization. The committee is satisfied that this change does not make the performance targets of the Plan less demanding.'*⁴⁷

The 2004 Report provided further detail as to the relevant criteria for the awards running through to 2006:

'The primary measure is BP's shareholder return against the market (SHRAM), which accounts for nearly two thirds of the potential total award, the remainder being assessed on BP's relative return on average capital employed (ROACE) and earnings per share growth (EPS).'

⁴⁵ Annual Report, (2009), p.85

⁴⁶ Annual Report, (2001), p.34

⁴⁷ Ref o/s - Annual Review, (2001), p.34

*BP's SHRAM is measured against the companies in the FTSE All World Oil & Gas Index. Companies within the index are weighted according to their market capitalization at the beginning of each three-year period in order to give greatest emphasis to oil majors. BP's ROACE and EPS growth are measured against ExxonMobil, Shell, Total and ChevronTexaco.*⁴⁸

But significantly, the basis had been changed for awards after that date:

*'For share element awards in 2005, the performance condition will relate to BP's total shareholder return (TSR) performance against the other oil majors (ExxonMobil, Shell, Total and ChevronTexaco) over a three-year period. TSR is calculated by taking the share price performance of a company over the period, assuming dividends to be reinvested in the company's shares. All share prices will be averaged over the three months before the beginning and end of the performance period and will be measured in US dollars. At the end of the performance period, the TSR performance of each of the companies will be ranked to establish the relative total return to shareholders over the period. Shares under the award will vest as to 100%, 70% and 35% if BP achieves first, second or third place respectively; no shares will vest if BP achieves fourth or fifth place.'*⁴⁹

This was maintained in 2006 and 2007, but revised again in 2008:

'Performance conditions for the 2009-11 share element will be somewhat modified from previous years. First, the peer group of oil majors against which we compare will be increased to include ConocoPhillips as well as ExxonMobil, Shell, Total and Chevron as previously. This change reflects ConocoPhillips' significant growth over the last few years, providing it with similar scale and global reach to the other oil majors.

Second, vesting of the shares will be based 50% on total shareholder return (TSR) versus the competitor group and 50% on a balanced scorecard of underlying performance versus the same competitors. The underlying performance will be assessed on three measures reflecting key priorities in BP's strategy – in Exploration and Production, hydrocarbon production growth, in Refining and Marketing, improvement in earnings per barrel, and group increase in underlying net income. Both Exploration and Production growth and Refining and Marketing earnings improvement are key strategic objectives for the group and this inclusion aligns key measures with both executive director priorities as well as key drivers of value for shareholders. Group increase in underlying net income acts as a holistic measure of success reflecting revenues, costs and complexity as well as safe and reliable operations.

*... As in previous years, performance shares will vest at 100%, 70% and 35% for performance equivalent to first, second and third rank respectively and none for fourth or fifth place. The three underlying measures will be averaged to form the balanced scorecard component. ...'*⁵⁰

⁴⁸ Annual Report, (2004), p.121

⁴⁹ Ref o/s - Annual Review, (2004), p.121

⁵⁰ Annual Report, (2008), p.82-83

This structure was maintained in 2009, but the weighting given to non-financial measures increased:

‘Performance conditions for the 2010-12 share element will continue the structure used in the 2009-2011 plan.

Vesting of shares will be based, as to one-third, on BP’s TSR compared with other oil majors over a three-year period and as to two-thirds, on a balanced scorecard of underlying performance. BP’s TSR performance will be compared with the other oil majors—ExxonMobil, Shell, Total, ConocoPhillips and Chevron.’⁵¹

In 2010 the weighting of performance shares returned back to half for financial measures and the other half will be based on value creation, reinforcing safety and risk management, and rebuilding trust rather than balanced scorecard standard.

‘Performance conditions for the 2011-2013 share element will be aligned with the strategic agenda that has evolved in response to last year’s events. This focuses on value creation, reinforcing safety and risk management, and rebuilding trust.

Vesting of shares will be based 50% on BP’s total shareholder return (TSR) compared to the other oil majors, reflecting the central importance of restoring the value of the company. A further 20% will be based on the reserves replacement ratio, also relative to the other oil majors, reflecting a central element of value creation. The final 30% will be based on a set of strategic imperatives for rebuilding trust; in particular, reinforcing safety and risk management culture, rebuilding BP’s external reputation, and reinforcing staff alignment and morale.’⁵²

As the overall figures above suggest initially the outcomes under the plan were very encouraging, for example:

‘For the 1998-2000 LTPP BP’s performance was assessed in terms of three-year shareholder return against the market (SHRAM) in relation to the following companies: Chevron, ExxonMobil, Shell and Texaco. BP came first in the 1998-2000 Plan, and the Remuneration Committee made the maximum award of shares to executive directors in 2001.

For the 1999-2001 Plan BP’s SHRAM again exceeded ChevronTexaco, ExxonMobil and TotalFinaElf, but came second to Shell.

The Remuneration Committee has also considered profitability and growth targets for the 1999-2001 Plan, i.e. return on average capital employed (ROACE) and earnings per share (EPS) growth. On both measures BP came first in assessing performance against the same oil companies.

⁵¹ Annual Report, (2009), p.86

⁵² Annual Report, (2010), p.115

Based on an initial performance assessment of 175 points out of 200, the committee expects to make an award of shares to executive directors...'⁵³

But relative performance began to decline particularly in respect to comparison of shareholder return. In 2002: *'BP's SHRAM came in at sixth place among the comparator group, fourth place on EPS growth and first place on ROACE'*⁵⁴ - which gave rise to a performance assessment of 80 points out of 200. An identical performance sixth, fourth and first was achieved in 2003 - but in that year the performance assessment was increased to 85 points. Things did not improve in 2004 - the first year of the use of the FTSE All World Oil & Gas index which saw a performance assessment of *'75 points out of 200 (0 for SHRAM, 50 for ROACE and 25 for EPS growth)'*⁵⁵ - a performance and assessment which was exactly repeated in 2005. In 2006 matters were still worse with a performance assessment of *'60 points out of 200 (0 for SHRAM, 50 for ROACE and 10 for EPS growth)'*⁵⁶

In 2007 a nadir was reached with - for the first time in the period under consideration - no shares being awarded:

*'Performance for the 2005-2007 share element was assessed relative to the TSR of the company compared with the other oil majors—ExxonMobil, Shell, Total and Chevron. BP's TSR result, reflecting past operating problems, was last relative to the other majors. The committee also reviewed the underlying business performance relative to competitors, including financial (ROACE, EPS, cash flow etc.) and non-financial (HSE etc.) indicators. While this showed some areas of strong performance, the committee's overall assessment, considering both the TSR result and the underlying performance, was that performance failed to meet satisfactory levels and consequently no shares will vest in the Plan for 2005-2007.'*⁵⁷

In 2008 operating under the new criteria based on TSR comparison with other oil majors, the company again signally failed to meet the targets set – however the remuneration committee decided to use its discretion to make awards amounting to £1.4m. It justified this accordingly:

'Performance for the share element is assessed relative to the TSR of the company compared with the other oil majors – ExxonMobil, Shell, Total and Chevron. Recognizing the inherent imperfections in a TSR ranking, the EDIP

⁵³ Annual Report, (2001), p.35

⁵⁴ Annual Report, (2002), p.38

⁵⁵ Annual Report, (2004), p.125

⁵⁶ Annual Report, (2006), p.69

⁵⁷ Annual Report, (2007), p.66

rules give the committee power to adjust (upwards or downwards) the vesting level derived from the TSR ranking if it considers that the ranking does not fairly reflect BP's underlying business performance relative to the comparators.

... For the 2006-2008 plan, BP was fifth relative to the other majors in terms of TSR when calculated on a common currency (US dollar) basis as originally anticipated. However, unusually large currency movements at the end of this period were an extraneous influence on this result. ... Again, the performance of the European comparators was quite similar: BP led the group on some measures (notably free cash flow and reserves replacement) but lagged on Refining and Marketing profitability. ...

Lord Browne also held an award under the 2006-08 share element related to long-term leadership measures. These focused on sustaining BP's financial, strategic and organizational health. Performance relative to the award was assessed by the chairman's committee and, based on this assessment, no shares were vested.⁵⁸

In 2009 a rather similar story unfolded:

'This momentum of improvement is also apparent over the three-year performance period covered by the 2007-2009 share element under the EDIP. Performance for the share element is assessed relative to the other oil majors – ExxonMobil, Shell, Total and Chevron. The committee follows the assessment process approved by shareholders in determining the vesting of shares that had been awarded at the start of 2007. ... To counter this the committee has the obligation to review both relative TSR and underlying performance to ensure a balanced judgement is made. Such was the case with regard to the 2007-2009 metrics.

The TSR result was tightly clustered for 2007-2009 with BP coming fourth based on our established methodology but very close to third place. As required by the plan, the committee reviewed a number of financial and operating metrics to assess relative underlying performance. These included the average change over the three years of EPS, ROACE, free cash flow, net income, production growth and Refining and Marketing profitability. ... Based on the full review and combining both the TSR and underlying analysis, the committee judged BP to be tied for third place and thus shared the vesting outcome for third and fourth place (35% and 0% respectively) as set out in the plan rules. The resulting 17.5% vesting for eligible participants is also shown in the table⁵⁹

This decision resulted in £2.5m being awarded to the four executive directors. In 2010 another nadir was reached with no shares being awarded - for the second time in the period under consideration - due to the massive oil-spill accident in the Mexican Gulf.

'Results for the 2008-2010 share element were also strongly affected by the Gulf of Mexico accident. BP's Total Shareholder Return (TSR) for the three-year period was lowest among the peer group of oil majors. The company's

⁵⁸ Annual Report, (2008), p.81

⁵⁹ Annual Report, (2009), p.84

underlying performance relative to the peer group actually remained quite strong on the metrics historically used to test the fairness of the TSR result. The committee felt, however, that because of the seriousness of the Gulf of Mexico accident, the TSR ranking was an appropriate result. No shares, therefore, vested under the plan for any executive director.’⁶⁰

2.3.5 Share Options

Although the LTIP framework still enables the use of share options effectively, these options have not been awarded since 2004 - however they were quite a significant part of the remuneration package in the early years of the period under examination. The criteria for the award of option shares in the years 2001-2004 was based on comparative returns, but in this case the comparison was with a wider group of companies - as noted in the 2001 Annual Report:

‘The share option element reflects BP’s performance relative to a wider selection of global companies. The committee will take into account BP’s total shareholder return (TSR) compared with the TSR for the FTSE Global 100 group of companies over the three years preceding the grant.’⁶¹

Options vested in equal proportions over the three years subsequent to the grant and had a life of seven years - and the same basis was used for 2002, 2003 and 2004. In terms of how these options were allocated (and over the period more than half of them went to Lord Browne), very little information is provided other than the statement in 2003 that:

‘In accordance with the framework approved by shareholders in 2000, it is the committee’s policy to continue to exercise its judgement in 2004 to decide the number of options to be granted to each executive director.’⁶²

Nor is any information as to valuation provided - although Black and Scholes (1972) type valuations were calculated by the company for the purposes of estimation of the proportion of executive director remuneration which was performance based.

2.3.6 Pensions

Until quite recently, the very significant sums provided to directors and senior executives in terms of pension contributions made on their behalf have received relatively little attention. This has to an extent changed consequent to the introduction of further requirements for disclosure - and also the impact of revelations as to

⁶⁰ Annual Report, (2010), p.114

⁶¹ Annual Report, (2001), p.34

⁶² Annual Report, (2003), p.110

particular cause celebres e.g. that of the chief executive of RBS referred to above. The basic construction of the BP scheme as it applied to UK based directors⁶³ was set out in the 2001 Annual Report as follows:

'Scheme members' core benefits are non-contributory. They include a pension accrual of 1/60th of basic salary for each year of service, subject to a maximum of two-thirds of final basic salary; a lump-sum death-in-service benefit of three times salary; and a dependant's benefit of two-thirds of the member's pension. The Scheme pension is not integrated with state pension benefits.

Normal retirement age is 60, but Scheme members who have 30 or more years' pensionable service at age 55 can elect to retire early without an actuarial reduction being applied to their pension.

Pensions payable from the Fund are guaranteed to be increased annually in line with changes to the Retail Prices Index, up to a maximum of 5% a year.

*Directors accrue pension on a non-contributory basis at the enhanced rate of 2/60ths of their final salary for each year of service as executive directors (up to the same two-thirds limit). None of the directors is affected by the pensionable earnings cap.'*⁶⁴

More information was added to the BP pension scheme as it applied to UK based directors in the 2002 Annual Report as follows:

*'In accordance with the company's long-standing practice for executive directors who retire from BP on or after age 55 having accrued at least 30 years' service, Mr Chase will receive an ex-gratia lump sum as a superannuation payment from the company equal to one year's base salary following his retirement. Lord Browne will remain eligible for consideration for such a payment. In the case of these individuals, all matters relating to such superannuation payments will be considered by the remuneration committee.'*⁶⁵
...

No significant change occurred in 2003. In 2004 the UK government had announced important proposals on pensions, the impact of which will be reviewed by the committee in 2005 in conjunction with BP studies into the wider effects of the new legislation for employees.⁶⁶ In 2005 no change happened. Further information was added in the 2006 Annual Report as follows:

'The rules of the BP Pension Scheme have recently been amended such that the normal retirement age is 65. Scheme members can retire on or after age 60 without reduction. Special early retirement terms apply to pre-1 December 2006 service for members with long service as at 1 December 2006.

⁶³ There is also significant detail provided as to the separate schemes relevant to US based directors – but space does not permit detailed exposition of these.

⁶⁴ Annual Report, (2001), p.37

⁶⁵ Annual Report, (2002), p.39

⁶⁶ Annual Report, (2004), p.122

*In April 2006, the UK government made important changes to the operation and taxation of pensions. The remuneration committee decided to deliver pension benefits in excess of the new lifetime allowance of £1.5 million set by the legislation via an unapproved and unfunded pension arrangement paid by the company direct.*⁶⁷

No change occurred in 2007. Additional information was provided in 2008, 2009 and 2010 Annual Reports related to Mr Inglis participation - as a member in the BP Pension Scheme - gave rise to a US federal tax liability as he was based in Houston - the amounts mentioned later on in section: Other Remuneration. Therefore the committee approved to discharge this US tax liability under a tax equalization arrangement in respect of each year.⁶⁸

Indicative figures show the speed at which the value of the benefit accruing to the executive directors rose. At end 2001 Lord Browne had accrued \$16.3m dollars in terms of transferable value⁶⁹, five years later at end 2006 this had risen to £21.7m. For Hayward the increase was even more dramatic, at end 2002 his transferable value was £1.3m, seven years later it had risen to £10.8m. For Grote over the same period the increase was from \$3.5m to \$12m. Furthermore the rules of the scheme appear to have been generous in the instance of early retirement. For example, the 2007 Annual Report notes that:

*‘Dr Allen is due to retire on 31 March 2008 and will be entitled to take an immediate unreduced pension. The figures in the table relate to 2007 and so do not include anticipated incremental cost of the unreduced pension (£1.36million).’*⁷⁰

2.3.7 Other Remuneration

Beyond these basic constituents of compensation there were also a variety of additional benefits covering travel provision, relocation and accommodation allowances; disclosure of consultancy contracts with former directors etc – the following is some details of which are provided over the period 2001-2010.⁷¹ Perhaps the most striking individual components of these non-standard aspects of

⁶⁷ Annual Report, (2006), p.71

⁶⁸ Annual Reports for period 2008-09-10 in pages 83-86-116 respectively.

⁶⁹ These figures were not disclosed until 2002 – the 2001 figure is a comparative.

⁷⁰ Annual Report, (2007), p.68

⁷¹ Through the period, there were payments relating to the cessation of contract for directors.

compensation were the £1.575m ex gratia lump sum payment to Lord Browne following his resignation in 2007, and the one-off retention awards of £1.5m shares made to both Conn and Inglis in February 2008.

In 2001 resettlement allowances for Mr Ford and Dr Grote were \$440,000 and \$300,000 respectively⁷², while in 2002 these allowances for Dr Grote was \$300,000 and Mr Ford \$110,000⁷³.

Resettlement allowances for Dr Grote was \$175,000 in 2003. Besides this Mr Chase was engaged as a consultant to BP in relation to the TNK-BP transaction, following his retirement in May 2003. He received \$50,000 gross per month plus expenses throughout the consultancy agreement which ended in May 2004. In July 2003 Mr Chase was also appointed as a BP nominated director of TNK-BP Limited⁷⁴. He received emoluments of \$120,000 from TNK-BP Limited during 2003.⁷⁵

Compensation for Mr Manzoni amounting to £50,000 paid relating to expatriate costs prior to his appointment as an executive director in 2004. Moreover Mr Olver was appointed on 1 July 2004 as a consultant to BP in relation to its activities in Russia following his retirement from BP p.l.c., and he had previously been appointed as a BP nominated director of TNK-BP Limited effectively on 20 April 2004. He received £150,000 in fees in 2004 and - as a director, deputy chairman and chairman of the audit committee of the joint-venture company - he received \$90,000 in fees from TNK-BP Limited throughout the consultancy agreement. Furthermore Mr Chase continued as a consultant to BP in relation to the TNK-BP transaction ended in May 2004 and he left the board of TNK-BP Limited in March 2004. He received \$250,000 in 2004 and - as a director, deputy chairman and chairman of the audit committee of TNK-BP Limited - he received \$30,000 in fees from that company throughout the consultancy agreement.⁷⁶

⁷² Annual Report, (2001), p.34

⁷³ Annual Report, (2002), p.36

⁷⁴ A joint-venture company owned 50% by BP

⁷⁵ Annual Report, (2003), p.112-113

⁷⁶ Annual Report, (2004), p.123and126

In 2005 Mr Olver continued as a consultant to BP in relation to its activities in Russia and served as a BP-nominated director of TNK-BP Limited. He received £300,000 in fees in 2005 in addition to reimbursement of costs and support for his role throughout the consultancy agreement. In addition, he is entitled to retain fees paid to him by TNK-BP up to a maximum of \$120,000 a year for his role as a director, deputy chairman and chairman of the audit committee of TNK-BP Limited.⁷⁷

Mr Olver still continued as a consultant to BP in relation to its activities in Russia and served as a BP-nominated director of TNK-BP Limited until 30 September 2006. He received £225,000 in fees in 2006 as well as reimbursement of costs and support for his role throughout the consultancy agreement. Additionally, he was entitled to retain fees paid to him by TNK-BP up to a maximum of \$120,000 a year for his role as a director, deputy chairman and chairman of the audit committee of TNK-BP Limited. On the other hand, Mr Miles⁷⁸ received £150,000 per annum since he was appointed as a director and non-executive chairman of BP Pension Trustees Limited in October 2006 for a term of three years.⁷⁹

Lord Browne resigned from the BP board on 1 May 2007, and he was awarded a lump sum ex gratia superannuation payment of one year's salary worth £1,575,000 in addition to the his pay package. On the other hand Mr Manzoni resigned from the board as well on 31 August 2007, and he was awarded compensation for loss of office equal to one year's salary worth £485,000 besides his remuneration parcel. Additionally he received £30,000 regarding statutory rights and retained his company car.⁸⁰

In 2008 a non-cash benefits amount of £212,000 includes costs of London accommodation provided to Mr Inglis. In addition BP discharged Mr Inglis a US tax liability arising on his participation in the UK pension scheme amounting to \$553,175 throughout a tax equalization arrangement. On the other hand Dr Allen left the company at the end of March 2008. He was entitled to one year's salary worth £510,000 as compensation for loss of office in accordance with his contractual

⁷⁷ Annual Report, (2005), p.171

⁷⁸ Non-executive director of BP until April 2006

⁷⁹ Annual Report, (2006), p.73

⁸⁰ Annual Report, (2007), p.65

entitlement, as well as a pro rata bonus for 2008 and continued full participation in the 2006-08 and 2007-09 share elements, according to the normal rules of the plan. Additionally he received £30,000 in respect of statutory rights and retained his company car. In February 2008 it was considered appropriate to strengthen the retention element of remuneration for two executive directors (namely: Mr Conn and Mr Inglis) as restricted shares amounting to £1.5m.⁸¹

Year 2009 reflects Mr Dudley's remuneration package since his appointment as executive director on 6 April 2009. A non-cash benefits amounting to \$304,000 includes costs of London accommodation and any tax liability thereon provided to Mr Dudley. In addition BP discharged Mr Inglis a US tax liability arising from his participation in the UK pension scheme amounting to \$90,314.⁸²

During 2010 a non-cash benefits amount of \$564,000 provided to Mr Dudley includes costs of London accommodation and any tax liability thereon. On 30 November 2010 Dr Hayward left the board, and awarded compensation for office loss equal to his salary for entire one year - worth £1,045,000 - besides his remuneration package, as well as £30,000 regarding statutory rights. On 31 October 2010 Mr Inglis left also the board, and awarded compensation for office loss equal to one year's salary - worth £690,000 - besides his pay package. In addition he received a further £200,000 for costs related to both repatriation and relocation consistent with his international assignment arrangements. Furthermore BP discharged Mr Inglis a US tax liability arising from his participation in the UK pension scheme amounting to \$1,260,000.⁸³

2.3.8 Non-executive Directorships

Over the period under examination BP board executive directors held a number of non-executive directorship positions in other companies. Chronologically in 2001 Browne was a non-executive director of Goldman Sachs Inc⁸⁴ as well as Intel Corporation, Buchanan was a non-executive director of Boots (where Ian Prosser had been a non- executive director from 1984 till 1996 and the chairman until 1999),

⁸¹ Annual Report, (2008), p.80and84

⁸² Annual Report, (2009), p.83

⁸³ Annual Report, (2010), p.112

⁸⁴ See: <http://contracts.corporate.findlaw.com/compensation/employment/2289.html>

Chase was a non-executive director of Computer Sciences Corp and Diageo, Ford was a non-executive director of USG Corp and Olver of Reuters Group.⁸⁵

In 2002 Chase added Tesco to his list of non-executive directorships and Hayward who appointed as executive director of BP in February 2003 became a non-executive director of Corus Group.⁸⁶ Buchanan, Chase, Olver and Ford had all given up their executive directorships by the end of 2003. In 2004 Conn became a non-executive director of Rolls-Royce (from January 2005) and Manzoni a non-executive director of SABMiller.⁸⁷ It is interesting to note that at that time BP did not comply with the provisions of the (then) Combined Code in terms of disclosing the fees received by executives for outside services – stating in the annual report:

‘The amount of fees received by executive directors in respect of their service on outside boards is not disclosed since this information is not considered relevant to BP.’⁸⁸

In 2006 Browne stood down as a non-executive director at Intel and Grote became a non-executive director at Unilever NV and Unilever plc.⁸⁹ In 2007 Browne left the company and there was more detailed disclosure as to the policy re non-executive directorships and for the first time disclosure of the extent of fees received:

‘The board encourages executive directors to broaden their knowledge and experience by taking up appointments outside the company. Each executive director is permitted to accept one non-executive appointment, from which they may retain any fee. External appointments are subject to agreement by the chairman and must not conflict with a director’s duties and commitments to BP. During the year, the fees received by executive directors for external appointments were as follows: Tony Hayward Corus £62,250 and Tata Steel £177, Iain Conn Rolls Royce £57,166, Byron Grote Unilever PLC £31,000 and Unilever NV €45,000, and Andy Inglis BAE Systems £39,661’⁹⁰

In 2008 Hayward stood down as a non-executive director of Corus but became a non-executive director and senior independent director of Tata Steel and Inglis became a non-executive director of BAE Systems.⁹¹

‘During the year, the fees received by executive directors for external appointments were as follows: Tony Hayward Tata Steel £83,000, Iain Conn

⁸⁵ Annual Report, (2001), p.39

⁸⁶ Annual Report, (2002), p.43

⁸⁷ Annual Report, (2004), p.128

⁸⁸ Annual Report, (2004), p.117

⁸⁹ Annual Report, (2006), p.65-66

⁹⁰ Annual Report, (2007), p.71

⁹¹ Annual Report, (2008), p.68-69

*Rolls Royce £65,000, Byron Grote Unilever PLC £33,500 and Unilever NV €48,625, and Andy Inglis BAE Systems £86,754*⁹²

In 2009 Hayward stood down as a NED at Tata Steel and the relevant disclosure details were as follows.⁹³

*‘During the year, the fees received by executive directors for external appointments were as follows: Tony Hayward Tata Steel £29,000, Iain Conn Rolls Royce £65,000, Byron Grote Unilever PLC £36,000 and Unilever NV €52,250, and Andy Inglis BAE Systems £90,000’*⁹⁴

In 2010 Hayward and Inglis left the company and the relevant disclosure note was as follows.⁹⁵

*‘During the year, the fees received by executive directors for external appointments were as follows: Iain Conn Rolls Royce £65,000, Byron Grote Unilever PLC £33,000 and Unilever NV €47,500, and Andy Inglis BAE Systems £49,280’*⁹⁶

2.4 The Remuneration Committee

The remuneration committee at BP is a long standing one. At the start of investigation period it was chaired by Robin Nicholson - who in a varied career had been an academic scientist, managing director of the European subsidiary of a Canadian nickel mining company, as well as a civil servant (as Chief Scientific Officer, Cabinet Office, 1983-1985) before taking up an executive directorship at Pilkington in 1986 and a non-executive directorship at Rolls Royce in 1986. He joined the BP board in 1987. He remained a board member of BP until the 2005 AGM when he retired at the age of 70. His replacement as chair of the remuneration committee was Dr DeAnne Julius - an American economist living in England⁹⁷ who had worked with the World Bank, British Airways and Shell before a four year spell (1997-2001) on the Monetary Policy committee of the Bank of England. She became a non-executive director of BP in 2001, as well as a non-executive director on a number of other boards – including Lloyds TSB from 2001-2007 where she was a member of the remuneration committee, and she is currently on the remuneration committee of Serco and Jones,

⁹² Annual Report, (2008), p.86

⁹³ Annual Report, (2009), p.67

⁹⁴ Annual Report, (2009), p.90

⁹⁵ Annual Report, (2010), p.84

⁹⁶ Annual Report, (2010), p.118

⁹⁷ Although her first full time employment was apparently as a CIA analyst at the time of the Vietnam War

and Lang Lasalle. Each member of the remuneration committee was (and is) subject to re-election every three years⁹⁸ – but Julius and Prosser (BP’s deputy chairman, previously CEO of Bass and until 2003 Intercontinental hotels⁹⁹) were members of the committee throughout the period under review and Davis, previously an AMOCO director, was a member from 2001 through to the 2009 AGM.¹⁰⁰ Knight - an American BP board member since 1987 (and also on the IBM remuneration committee throughout the period)¹⁰¹ - was a member from 2001 to 2005. In 2004 Bryan - a director of BP since 1998 having previously been a director of AMOCO - joined the committee. Bryan was contemporaneously a non-executive director of General Motors and Goldman Sachs (where he was a member of the remuneration committee) and remained a member of the BP remuneration committee until retiring at the age of 70 in April 2007. In 2004 Tom McKillop joined the BP board and became a member of the remuneration committee. McKillop - a chemist and CEO of Zeneca and then AstraZeneca from 1993 to end 2005 - had been a non-executive director of Lloyds TSB from 1999-2004 and then became chairman of the Royal Bank of Scotland (RBS). He resigned from this position after the collapse and government bail-out of RBS in 2008 and, somewhat reluctantly, stood down as a director of BP at the 2009 AGM following shareholder concerns as to his suitability as a non-executive director. In 2009 there were two additions to the committee: Anthony Burgmans and George David. Burgmans had joined the BP board in 2004 having previously been an executive director and then vice-chairman of Unilever and is a member of a number of Dutch supervisory boards. David joined the board in 2008 having previously been CEO of United Technologies Group (UTC) from 1994-2008 (and chairman 1997-

⁹⁸ It is unclear whether this referred to internal reelection to the remuneration committee or reelection as a director at the AGM – which is now an annual process.

⁹⁹ *‘Sir Ian is a fixture of the FTSE 100 having sat on the boards of five blue chips including Boots and Lloyds TSB. He is still deputy chairman of BP and is the senior independent non-executive on the board of GlaxoSmithKline, the drugs giant. His heroes are James Hanson, the great conglomerate builder, and Lord Browne, whose capture of Amoco helped transform BP’s fortunes. People who have worked with him say those of a weak disposition easily get steamrollered in the face of Sir Ian’s strongly held views, although a confident, well-argued case will lead to a change of mind. A physically imposing figure, his allies say he has great skills in chairing meetings and can be extremely charming when organising and cajoling for things to get done.’*

See: <http://www.independent.co.uk/news/business/news/sir-ian-prosser-chief-with-a-mission-to-win-over-sainsburys-sceptics-569982.html>

¹⁰⁰ In 2009, Erroll Davis became a board member at General Motors.

¹⁰¹ Knight had been a highly successful chair of a US technology firm Emerson Electric – ‘*CalPERS placed Emerson on its "focus" list in July 2004 after becoming dissatisfied with its classified board and with a retirement package for Knight it maintained was excessive.*’

See: <http://www.allbusiness.com/human-resources/employee-development/1052703-1.html>

2007). From 2002-2008 he was a board member at Citigroup – leaving the board following criticism of board members’ failure to protect investors and other stakeholders.¹⁰² In 2010 Ian Davis joined as a new member of the BP’s remuneration committee. He had joined the BP’s board in April 2010 having previously pursued a career at Bowater and then McKinsey where he rose to be the managing partner in UK and Ireland and then chairman and worldwide managing director. He retired as senior partner of McKinsey in July 2010.

Apart from the formal members of the committee, other interested parties were in attendance - perhaps most significantly the BP chairman throughout the period Peter Sutherland.¹⁰³ Sutherland’s career had taken him from a background in law and politics in Ireland, at 34 years old as the youngest ever Irish Attorney General, into the European Commission as its youngest ever Commissioner and then general director of GATT (now the World Trade Organisation). He was a non-executive director of BP over the period 1990-1993 and then was reappointed in 1995. He became chairman in 1997 and retained that post until end 2009. Sutherland was chairman of Allied Irish in the early 1990s and subsequently became a non-executive director and chairman of Goldman Sachs International - a position which he still holds. He was a non-executive director and member of the remuneration committee of RBS from 2001 until 2009 when he resigned following the government rescue operation.¹⁰⁴

¹⁰² George David stepped down as the day-to-day boss of United Technologies Corp. almost two years ago, but the money keeps rolling in from his long run at the top. David’s total compensation at UTC in 2009, his last year as chairman, came to \$65.3 million

(in 2004 his highest paid year total compensation from UTC had been \$84m)

See: http://www.tradingmarkets.com/news/stock-alert/utx_former-utc-chief-george-david-pulls-in-65-million-in-2009-810020.html

In 2009 in the rather public divorce action between him and his, thirty years younger, second wife David itemised his weekly expenditure as \$200,000 a week – approximately half of which went on the running costs of his yacht.

See: http://www.google.com/search?hl=en&q=george+david+utc+divorce&aq=1&aqi=g2&aql=&oq=George+David+UTC&gs_rfai=

(the boat capsized in the 2011 Fastnet Race – fortunately all on board – including David - were rescued without serious injury)

¹⁰³ *The chairman of the board also attends committee meetings.* (Annual Report, 2004, p.116)

Mr Sutherland, as chairman of the board, attended all committee meetings. (Annual Report, 2006, p.73)

¹⁰⁴ ‘Described as a ‘larger than life’ character, he insists that his reported £150million fortune is not an important part of his life.’ (It is not entirely clear from his CV how he managed to amass so much money in a career, a significant part of which has been devoted to public service – although as he apparently gives financial advice to the Pope, it may be that he had divine inspiration on his side.) See: http://www.thisismoney.co.uk/news/article.html?in_article_id=491892&in_page_id=2

The remuneration committee met between five (2001, 2002, 2006) six (2003, 2005, 2007, 2008, 2010) seven (2004) and eight (2009) times a year. When provided - the attendance records suggest that the chairman was almost invariably in attendance.

There is also some evidence of attendance by the CEO and other executive directors:

*'The committee consults the group chief executive on matters relating to other executive directors who report to him. He is not present when matters affecting his own remuneration are considered. The chairman of the board also attends meetings when appropriate.'*¹⁰⁵

*'Lord Browne (group chief executive) was consulted on matters relating to the other executive directors who report to him and, together with Dr Allen (group chief of staff), on matters relating to the performance of the company. Neither was present when matters affecting his own remuneration were considered.'*¹⁰⁶

However little detail as to executive director attendance is provided in subsequent reports.

The committee also engaged outside advisers:

*'The committee is serviced independently of the executive management and actively seeks advice from external professional consultants.'*¹⁰⁷

'Advice is provided to the committee by the company secretary's office, which is independent of executive management and reports to the non-executive chairman. ...

During 2002, the following people provided advice or services on specific matters to the committee that materially assisted it in its consideration of matters relating to executive directors' remuneration:

- *Mr Sutherland (chairman); Lord Browne (group chief executive), who was consulted on matters relating to the other executive directors who report to him and on matters relating to the performance of the company. He was not present when matters affecting his own remuneration were considered; Mr Iain Macdonald (group vice president, planning, performance management and control, for the company), who provided to the committee some of the company's calculations for the performance-related pay which were then subject to independent verification by Ernst & Young as auditors; ...*

- *Towers Perrin who, during 2002, have been the committee's principal advisers on matters of executive directors' remuneration and who also provided some ad hoc remuneration and benefits advice to parts of the group, mainly comprising pensions advice in Canada; Kepler Associates, ...'*¹⁰⁸

See: http://www.powerbase.info/index.php?title=Peter_Sutherland for more detailed coverage of Peter Sutherland's career.

¹⁰⁵ Annual Report, (2001), p.37

¹⁰⁶ Annual Report, (2003), p.109

¹⁰⁷ Ref o/s - Annual Report, (2001), p.37

¹⁰⁸ Annual Report, (2002), p.33

In 2003 Towers Perrin became the principal adviser:

‘The committee appointed Towers Perrin as its principal external adviser during 2003 on matters of executive directors’ remuneration. Towers Perrin also provided some limited ad hoc remuneration and benefits advice to parts of the group, mainly comprising pensions advice in Canada.’¹⁰⁹

In 2004 the remuneration committee sought outside advice in terms of the appropriate parameters for compensation:

‘In 2004, the committee consulted three independent academics, Michael Jensen, professor emeritus of Harvard Business School, and professors Sir Andrew Likierman and James Dow, both of London Business School, in connection with its fundamental review of remuneration policy.’¹¹⁰

Subsequent disclosures as to the extent of outside support have been relatively limited – for example the 2008 Annual Report states simply:

‘The committee is independently advised.’¹¹¹

2.5 Reaction and Feedback

Over the last fifteen years there have been intermittent expressions of concern by the media, shareholders and other stakeholders as to the level of remuneration provided by BP to its executive directors – a number of relevant quotations are contained in Appendix 2 – but it was not until the 2009 AGM that there was a significant organised protest against aspects of the directors remuneration report. As reported in one newspaper:

‘Shareholders of BP have been urged to next week vote against the oil giant’s remuneration report by PIRC, the corporate governance watchdog.

BP’S chief executive, Tony Hayward, was awarded a 41 per cent pay rise in 2009 despite the company’s profits coming in more than 50 per cent down on the previous year. It said: “PIRC considers that combined remuneration was excessive in the year under review and is also concerned regarding the lack of transparency surrounding the performance conditions attached to the Executive Directors Incentive Plan.”¹¹²

¹⁰⁹ Annual Report, (2003), p.109

¹¹⁰ Annual Report, (2004), p.119

¹¹¹ Annual Report, (2008), p.75

¹¹² See, the Independent report:

<http://www.independent.co.uk/news/business/news/pirc-urges-no-vote-on-bp-director-pay-1938347.html>

This did in fact result in a protest vote far higher than is common with 38% of votes not supporting the directors' remuneration report.

3. Content Analysis¹¹³

The majority of the discussion and analysis in the paper is inductive based on discursive review of the disclosures in the BP annual reports for the period under examination. However this is supplemented by an exploratory content analysis (Collis and Hussey, 2003; and Yin, 2009) which seeks to relate certain keywords and the frequency of their repetition to the manner in which BP sought to portray its remuneration policies. Clearly this is an area where the analysis and its interpretation can only be indicative – it is all but impossible to say whether the manner in which BP sought to profile and depict its remuneration policies actually drove what the policies were. However it is suggested that the exploratory analysis is of interest and might perhaps shed some light both on how BP perceived itself and how it wished other interested parties and stakeholders to perceive it.

The table in Appendix (3) demonstrates the results of searching process for a number of most repeated words via showing the word length, number and volume of references, and similar terms in the concept within BP directors' remuneration reports over the ten year period. Here the focus has been on three key words - 'Remuneration', 'Performance' and 'Governance' - although coding was also done for other words such as Executive, Director, Year, Committee ... etc. The results suggest that the term 'Performance' related both to the overall BP activities (833 references – 0.67% of total word count), and to the core of the work of the executives' role (1701 – 2.2%). The term 'Governance' referred both to institutional authority and control exercised (88 –

¹¹³ The content analysis - a qualitative data analysis approach (Collis and Hussey, 2003) - has been applied in a number of the accounting literature for examining management remarks (Aerts 1994), accounting standards (Bennett et al. 2006), and exposure drafts' submission (Yen et al. 2007); however no prior research has analyzed the content of directors' remuneration reports. This analysis is used to extract sense and meaning from textual materials so as to determine the presence of common concepts, themes, phrases, and numbers in an objective manner (Collis and Hussey, 2003). Over the period under examination NVivo utilizes to identify and gather the selected terms (i.e. nodes), code terms of interest, and examine coded terms by using a set of analytical techniques (Yin, 2009) - which assist in establishing the existence and frequency of concepts in a text (conceptual 'thematic' analysis), and examining and mapping the relationships among these concepts (relational 'network' analysis). Subject to the research questions, these techniques are used to identify whether the coded terms - i.e. Remuneration, Performance, and Governance - in BP directors' remuneration reports are more prevalent and whether the prevalence of coded terms changes over time.

0.04%), and to the corporate rules and regulations applied (137 – 0.10%). The term ‘Remuneration’ (including references to compensation and pay) was - perhaps not surprisingly - expressed in terms of the concept of what executive directors received in the form of salary and earnings (1222 – 1.92%), excluding other payment expressions - for example bonus, pension, option, allowance ... etc.

Further matrix coding analysis as set out in Appendix 4 shows in more detail not only the frequency of terms’ existence, but also the number of instances where the coding of two or more documents (the sources) within the ten year span and the nodes (the terms) overlap. This form of analysis also provides a check on contradictions or possible overlap between terms - such as the case of terms: ‘Performance’ and ‘Executive’, in addition to ‘Governance’ and ‘Regulations’. For example there is a ‘Performance’ overlap of 742 references in term ‘Executive’, while the term ‘Governance’ overlaps 21 times in term ‘Regulations’. The results suggest that there are 742 references from the 1701 ‘Executive’ references relate to *Executive Performance* and the rest refer therefore to the non-performance role of executives. In addition there are 21 references from the 137 ‘Regulations’ relate to *Rules of Corporate Governance* and the remainder refer to the non-governance regulations. On the other hand the references of term ‘Remuneration’ do not overlap with pay components - such as allowance, award, benefits ... etc - as it combines just salary and earnings in ‘Remuneration’ similar terms as mentioned above.

The chart in Appendix (5) illustrates the frequency of pooled references for the three key words - ‘Remuneration’, ‘Performance’ (whatever related to BP or executive member) and ‘Governance’ - as reported in separate in BP directors’ remuneration reports within years between 2001 and 2010. In 2001 the references to the remuneration package account for 195, while the BP and executive performance references are similar in number with 42 and 40 respectively. By 2002 the references to compensation package reach to its peak, 374, whilst in 2004 BP and executive performing roles are a top numbering of references via 110 and 103 correspondingly. In 2006 the references to pay package, as well as BP and executive performances fall to 248, 77, and 64 respectively. In 2010 the relative weighting of remuneration references increased to 312, whilst BP and executive performance references are similar to those in 2006, 72 and 62 respectively. Perhaps surprisingly the references to

‘Governance’ - in terms of relating the governance structure to the executives’ pay and performance - are few in number and have declined from 21 in 2002 till 5 in 2008 and 2010.

These findings which show that the term *BP Performance* had more significance and awareness in references (833¹¹⁴ - 0.67%¹¹⁵) than the term *Executive Performance* (742¹¹⁶ - 0.96%¹¹⁷) in directors remuneration reports, may be interpreted as suggesting the BP remuneration committee put more focus on the link between executive directors’ remuneration with the overall BP performance rather than the actual executive performance. In turn this finding might be a contribution explanator as to why 38% of BP shareholders have voted in April 2010 against the remuneration committee’s report.

Finally word similarity analysis as set out in Appendix 6 shows a relational table analysis of similarity between two terms via the coefficient of Pearson correlation¹¹⁸. The Pearson coefficients between each pair in all three cases - ‘Performance’ and ‘Remuneration’, ‘Governance’ and ‘Performance’, and ‘Governance’ and ‘Remuneration’ - are near to -1, which means that there is little similarity or overlap in each case which is indicative of an absence of contradiction in node concepts and purposes. In this contest, two cluster analysis diagrams are depicted. First left-hand side figure is a horizontal tree diagram, which indicates how ‘Governance’ influence and control the relationship between ‘Performance’ and ‘Remuneration’, while second right-hand side graph is a 3D cluster diagram, which demonstrates how far the distances of overlap between the three key terms are.

4. Reflections and Conclusions

The case study can be interpreted in a variety of ways. From a theory perspective it is difficult to find significant support for a pure agency theory type world in which contracts are drawn up so as to maximize effort and expertise on behalf of the

¹¹⁴ 833: See Word Counting Table in Appendix (3)

¹¹⁵ 0.67%: See Word Counting Table in Appendix (3)

¹¹⁶ 742: See Matrix Coding Analysis in Appendix (4)

¹¹⁷ 0.96%: $(742/Executive:1701)*2.20\%$

¹¹⁸ The Pearson correlation coefficient is a similarity metric which indicates the calculation of similarity between each pair of nodes by showing the number of times the first term row appears in the second term column.

shareholders. Of course one always has to consider the counterfactual - what would the position be without the remuneration packages put in place? but it is far from clear what the linkages are or were between the designed packages and actual performance. There is perhaps stronger evidence linking toward a managerial hegemony perspective but one heavily mediated by the presence of powerful non-executive directors and the institutional presence of the remuneration committee.

There is little evidence that the packages were dictated by mobility within the international labour market – notwithstanding the retention payments made to both Conn and Inglis the lack of mobility at the highest levels of the company is strikingly singular. It might be interpreted that bringing onto the board people with a background of very high remuneration in North America might lead to a situation in which remuneration packages in the UK were advanced accordingly. Perhaps the most significant aspects to emerge are the importance of personal relationships and power at boardroom level. At one level the social contacts binding members of the board together included sailing, links to Cambridge University etc but when there was a fracture in the nature of these contacts there were significant implications in terms of remuneration. Clearly the falling out between Browne and Sutherland was a major driver in terms of the remuneration decisions taken in 2007. Institutionally it is difficult to say that the remuneration committee demonstrated any consistency of purpose – perhaps beyond that of acceding to the wishes of those powerful executive and non-executive directors who might be seen as acting as the committee’s puppet masters. Over the period under examination the nature of the various incentive packages changed as did that of the targets which it was necessary to achieve in order to benefit from the packages. Although the rhetoric used - ‘demanding’, stretching’, ‘rigorous’ - suggests that the targets associated with the cash bonus were difficult to achieve the reality was that they appear to have been all but fully achieved in almost all the years under examination. However the achievement of these targets was not associated with superior share price performance vis-à-vis other oil majors nor indeed against the wider UK stock market. One might consider whether the shift away from pure share return based incentives under the Long Term Incentive Plan toward more of a ‘balanced scorecard’ approach might have been associated with the fact that these other targets were rather more arbitrary and likely to be much more achievable. Similarly one might wonder why the comparator group – particularly in relation to

share return – changed so frequently over the period, and of course why having failed to achieve targets the remuneration committee on more than one occasion decided that the near achievement of a target was in fact sufficient to justify payment as if that target had been achieved.

The supplementary content analysis set out in section 3 is of course purely indicative as an interpretation of the manner in which BP remuneration committee and board approached issues as to the manner in which remuneration in the company is established and the links between performance and remuneration. However inferences can be made which are suggestive of a focus on BP's overall performance rather than on the specific activities and achievements of individual directors.

In conclusion many have questioned the validity of a pure agency theory model either as a normative or explicative model of executive compensation and many have pointed to the importance of personality and power relations within the boardroom as determinants of the amount of remuneration and who actually receives it. However to date there has been much less questioning of the role of the remuneration committee as an institutional construct and indeed of whether it constrains, obscures, or adds pseudo legitimacy to in terms of boardroom and senior management compensation. *Inter alia* this paper does call into question the manner in which the remuneration committee at BP operated over the years under examination and adds some weight to the more general questioning (e.g. Gwilliam and Marnet, 2009) as to whether the accepted governance paradigm of non-executive directors and boardroom committees (audit, nomination, remuneration) does in fact add anything significant to the quality of governance – or whether indeed it acts as an unintentional smokescreen to poor governance behaviour.

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Appendix 1: BP Executive Directors' and CEO's Compensation Packages with Descriptive Statistics

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Median	SD	Min.	Max.
Panel A: Directors' Compensation Packages from 2001 till 2010 (£,000)														
Salary	3,702	2,743	3,421	3,248	3,699	3,879	3,104	3,197	3,751	2,343	3,309	488.894	2,343	3,879
Bonus	5,159	3,437	4,582	5,079	4,217	2,168	4,078	4,657	6,494	238	4,011	1,744.1	238	6,494
DC Pensions	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Others	695	302	262	217	206	216	265	277	479	405	332	154.41	206	695
Value of Equity Awarded	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Value of LTIP Awarded	13,748	9,350	15,599	14,484	26,317	21,515	15,447	16,391	4,278	1,552	13,868	7,376.9	1,552	26,317
Intrinsic Value of Options Awarded	0	0	1,858	2,426	3	2	0	0	0	0	429	912.755	0	2,426
Estimated Value of Options Awarded	6,499	3,417	5,474	6,274	5	7	0	2	2	0	2,168	2,910.49	0	6,499
Total Remuneration during the Period	29,108	18,947	29,076	29,085	34,238	27,569	22,629	24,247	14,525	4,538	23,396	8,740.98	4,538	34,238
Number of Executives	6	4	6	6	6	6	5	4	5	3	5	1.1005	3	6
Panel B: CEO's Compensation Packages from 2001 till 2010 (£,000)														
Salary	1,193	1,203	1,316	1,382	1,451	1,531	877	998	1,045	760	1,176	252.99	760	1,531
Bonus	1,772	1,588	1,882	2,280	1,750	900	1,262	1,496	2,090	0	1,502	659.4	0	2,280
DC Pensions	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Others	55	49	79	82	90	95	14	15	23	365	87	102.48	14	365
Value of Equity Awarded	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Value of LTIP Awarded	4,457	3,947	5,699	6,509	12,472	10,066	4,344	4,444	1,183	376	5,350	3,668.67	376	12,472
Intrinsic Value of Options Awarded	0	0	847	1,365	0	0	0	0	0	0	221	482.05	0	1,365
Estimated Value of Options Awarded	3,256	2,220	2,662	3,523	0	0	0	0	0	0	1,166	1,543.08	0	3,523
Total Remuneration during the Period	10,678	8,958	11,559	13,694	15,673	12,497	6,483	6,938	4,318	1,501	9,230	4,426.84	1,501	15,673

Notes: This table recaps a number of descriptive statistics for BP executives' and CEO's remuneration components from 2001 until 2010, amounts are presented through British Pounds. All pay components are rounded to the nearest thousand. Panel A reports statistics relating to BP board executives, while Panel B presents similar figures for BP CEO pay. The average pay components are derived from the total remuneration during the period over the number of executives.

Appendix 2: Concerns of Relevant Parties on BP Executives' Remuneration - Quotations

The Independent report - under the title: "Golden handshake boosted Lord Simon's BP pay packet to pounds 599,000" - states the following:

'LORD SIMON of Highbury, who resigned as chairman of BP last May to take up a ministerial post in Tony Blair's government, received pounds 599,000 from the company in 1997, including a discretionary payment of pounds 240,000 in recognition of his 36 years service.

Lord Simon's total pay from BP was almost six times the amount Mr Blair drew as Prime Minister and nearly 12 times the amount he was entitled to as a minister of state in the House of Lords.

A BP spokesman said the decision to make the ex gratia payment of pounds 240,000 to Lord Simon was not unusual. "The board decided to give him an honorarium, which is quite common when people retire from BP."

The annual report also shows John Browne, BP's chief executive, took home pounds 1.76m, including pounds 821,000 awarded to him under the company's long-term performance plan. This year he stands to receive a maximum award worth pounds 815,000 under the scheme.

The 365 BP executives who are participate in the plan stand to receive shares worth pounds 22m this year. Awards under the scheme are based on growth in total shareholder return.

In the three years from 1995 to 1997 - the period over which the 1998 award will be based - BP's total shareholder return was 19.5 per cent, beating the market.

In 1996 Mr Browne's total remuneration was higher at pounds 2.46m but this included a pounds 1.72m payment under a previous five-year incentive scheme.

Mr Browne's remuneration, excluding his long-term share award, rose by 25 per cent to pounds 938,000, reflecting the bumper year enjoyed by BP.¹¹⁹

The Find Article report - under the title: "executives strike rich BP bonuses" - states the following:

'Four other BP executives will earn over [pounds sterling]1m. Deputy chief executive Rodney Chase stands to get [pounds sterling]1.4m, finance director John Buchanan [pounds sterling]1m.

Retiring directors Russell Seal and Rolf Stomberg should get [pounds sterling]1.3m and [pounds sterling]1.2m.

Stomberg also gets a [pounds sterling]1.5m pension fund top-up.

BP says: 'The company put in an all-time record performance - [pounds sterling]2.8bn profits. It earned the best return on capital of all major oil companies. That deserves reward, and rewards help to achieve performance.'¹²⁰

¹¹⁹ See, the Independent report: <http://www.independent.co.uk/news/business/golden-handshake-boosted-lord-simons-bp-pay-packet-to-pounds-599000-1150815.html>

The Mail Online report - under the title: “BP shareholders outrage at Lord Browne's £72m goodbye” - states the following:

‘One shareholder, Mike Porter, said BP had "broadly underperformed" the FTSE 100 index. Another, John Farmer, added that the company's performance was "arguably pathetic" and called upon the board to justify pay packages.

BP chairman Peter Sutherland said: "It is important to discuss remuneration in the context of overall performance. For example, our net income growth is higher than our two largest competitors last year.

"We have to retain the best that we have, and we believe that they are the best."”¹²¹

¹²⁰ See, the Find Article report: http://findarticles.com/p/news-articles/daily-mail-london-england-the/mi_8002/is_1998_March_17/executives-strike-rich-bp-bonuses/ai_n35936500/

¹²¹ See, the Mail Online report: <http://www.dailymail.co.uk/news/article-448171/BP-shareholders-outrage-Lord-Brownes-72m-goodbye.html>

Appendix 3: Word Searching/Counting Analysis

Word	Length	Count	Weighted Percentage	Similar Words
executive	9	1701	2.20	action, actions, do, doing, executive, executives, implement, implementation, implemented, implementing, perform, performance , performances, performing, practicable, practice, practice', practices, run
directors	9	1166	1.99	director, directors, directors', managed, management
remuneration	12	1222	1.92	compensated, compensation , earn, earned, earning, earnings, earns, pay , remunerating, remuneration, salaries, salary
year	4	940	1.55	age, ages, annual, annually, class, day, days, year, years, years', yrs
share	5	902	1.45	contributed, contribution, contributions, deal, divided, part, partly, parts, percentage, portion, share, shared, shares, sharing
committee	9	693	1.20	commissioned, commissioning, committee, committees
award	5	520	0.74	award, awarded, awards, grant, granted, grants, present
plan	4	442	0.71	design, designed, plan, planned, planning, plans, prepared, programme, project, projects, provision, provisions
performance	11	833	0.67	acted, acting, acts, do, doing, functional, operated, operates, operating, operation, operational, operationally, operations, perform, performance , performances, performing
value	5	564	0.59	appreciation, assess, assessed, assesses, assessing, assessment, assessments, evaluate, evaluated, evaluation, evaluations, measure, measured, measurement, measures, measuring, rate, rated, rates, rating, respect, respective, respectively, respects, value, valued, values
set	3	604	0.56	adjust, adjusted, adjusting, adjustment, adjustments, arrangement, arrangements, background, circumstances, context, defined, determination, determine, determined, determines, determining, do, doing, fixed, limit, limited, limits, local, place, placed, places, position, positioning, positions, positive, prepared, put, scene, scope, set, sets, setting, specified
bonus	5	335	0.49	bonus, bonuses, incentive, incentives
shareholders	12	272	0.47	shareholder, shareholders, shareholders', shareholding
pension	7	259	0.45	pension, pensionable, pensions
option	6	212	0.36	alternative, choice, option, options, selected, selection
measures	8	398	0.33	amount, amounting, amounts, barring, calculated, calculating, calculation, calculations, careful, carefully, deliberations, measure, measured, measurement, measures, measuring, metric, metrics, standard, standards, stepped
contracts	9	247	0.29	contract, contracts, narrow, reduce, reduced, reducing, signed, take, takes, taking, undertaking
benefits	8	167	0.27	benefit, benefits, gain, profit, profitability, profits
practice	8	409	0.27	applied, applies, apply, applying, commitment, commitments, committed, do, doing, exercisable, exercise, exercised, exercises, exercising, good, much, operated, operates, operating, operation, operational, operationally, operations, practicable, practice, practice', practices, use, used, using, virtually
allowance	9	300	0.21	adjust, adjusted, adjusting, adjustment, adjustments, allow, allowance, allowances, allowing, allows, leave, leaving, margin, marginally, permits, permitted, provide, provided, provides, providing
regulations	11	137	0.10	governance , governed, government, order, regular, regularly, regulations, regulatory, rules
pay	3	126	0.06	compensated, compensation , give, gives, pay
compensation	12	68	0.04	compensated, compensation , cover, covered, covering, covers, repairs, right, rights
governance	10	88	0.04	authority, authorization, authorized, control, establish, established, establishing, establishment, governance , governed, government, organic, organization, regime

Appendix 4: Matrix Coding Analysis

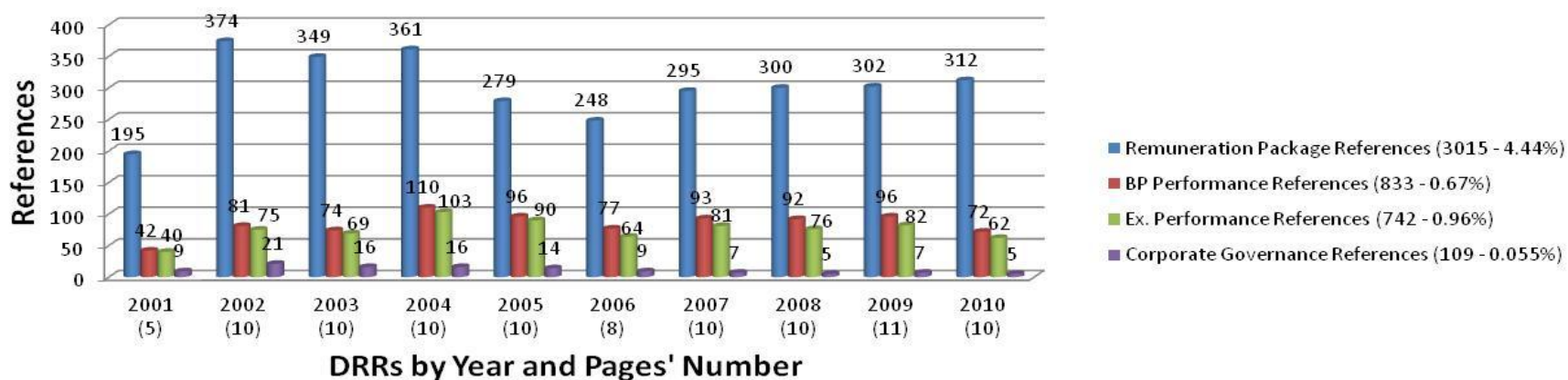
		Sources										Terms											
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	
Sources	1: DRR 2001	6	0	0	0	0	0	0	0	0	0	7	6	42	87	77	8	33	17	18	19	23	
	2: DRR 2002	0	11	0	0	0	0	0	0	0	0	15	23	81	198	128	40	74	30	34	40	28	
	3: DRR 2003	0	0	11	0	0	0	0	0	0	0	12	14	74	171	109	26	84	20	38	44	28	
	4: DRR 2004	0	0	0	11	0	0	0	0	0	0	13	17	110	205	132	39	83	17	37	29	24	
	5: DRR 2005	0	0	0	0	11	0	0	0	0	0	12	15	96	192	111	31	45	18	32	15	27	
	6: DRR 2006	0	0	0	0	0	9	0	0	0	0	7	15	77	151	127	20	36	0	28	11	26	
	7: DRR 2007	0	0	0	0	0	0	11	0	0	0	6	14	93	185	132	34	52	0	36	14	27	
	8: DRR 2008	0	0	0	0	0	0	0	11	0	0	5	17				40	36	20	27	11	28	
	9: DRR 2009	0	0	0	0	0	0	0	0	12	0	6	9	BP Performance			32	35	25	41	10	23	
	10: DRR2010	0	0	0	0	0	0	0	0	0	11	5	7	72	163	132	30	42	20	44	19	25	
Terms	11: Governance	7	15	12	13	12	7	6	5	6	5	88	21	0	0	0	0	0	0	0	0	0	
	12: Regulations	6	23	14	17	15	15	14	17	9	7	21	137	0	0	0	0	0	0	0	0	0	
	13: Performance	42	81	74	110	96	77	93	92	96	72	0	0	833	742	0	0	0	0	0	0	0	
	14: Executive	87	198	171	205	192	151	185	173	176	163	0	0	742	1701	0	0	0	0	0	0	0	
	15: Remuneration	77	128	109	132	111	127	132	138	136	132	0	0	0	0	1222	0	0	0	0	0	0	
	16: Allowance	8	40	26	39	31	20	34	40	32	30	0	0	0	0	0	300	0	0	0	0	0	
	17: Award	33	74	84	83	45	36	52	36	35	42	0	0	0	0	0	0	520	0	0	0	0	
	18: Benefits	17	30	20	17	18	0	0	20	25	20	0	0	0	0	0	0	0	167	0	0	0	
	19: Bonus	18	34	38	37	32	28	36	27	41	44	0							0	0	335	0	0
	20: Option	19	40	44	29	15	11	14	11	10	19	0							0	0	0	212	0
	21: Pension	23	28	28	24	27	26	27	28	23	25	0	0	0	0	0	0	0	0	0	0	0	259

Remuneration Package	DRR 2001	DRR 2002	DRR 2003	DRR 2004	DRR 2005	DRR 2006	DRR 2007	DRR 2008	DRR 2009	DRR 2010	TOTAL
	'Governance' overlap in 'Regulations'	2	6	4	3	2	2	1	0	1	0
'Performance' overlap in 'Executive'	40	75	69	103	90	64	81	76	82	62	742

Appendix 5: Key Word Reference Chart

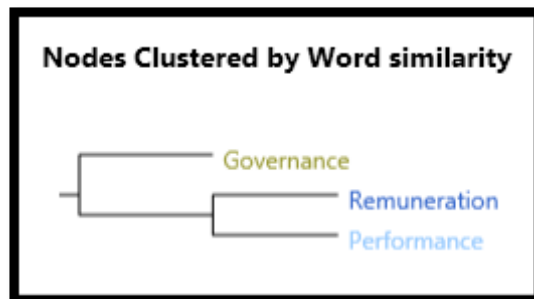
DRRs by YEAR	Number of Pages	Remuneration Package References	BP Performance References	Executive Performance References	Corporate Governance References
2001	5	195	42	40	9
2002	10	374	81	75	21
2003	10	349	74	69	16
2004	10	361	110	103	16
2005	10	279	96	90	14
2006	8	248	77	64	9
2007	10	295	93	81	7
2008	10	300	92	76	5
2009	11	302	96	82	7
2010	10	312	72	62	5
TOTAL		3015 (4.44%)	833 (0.67%)	742 (0.96%)	109 (0.055%)

Remuneration, Performance, and Governance References within BP DRRs 2001-10

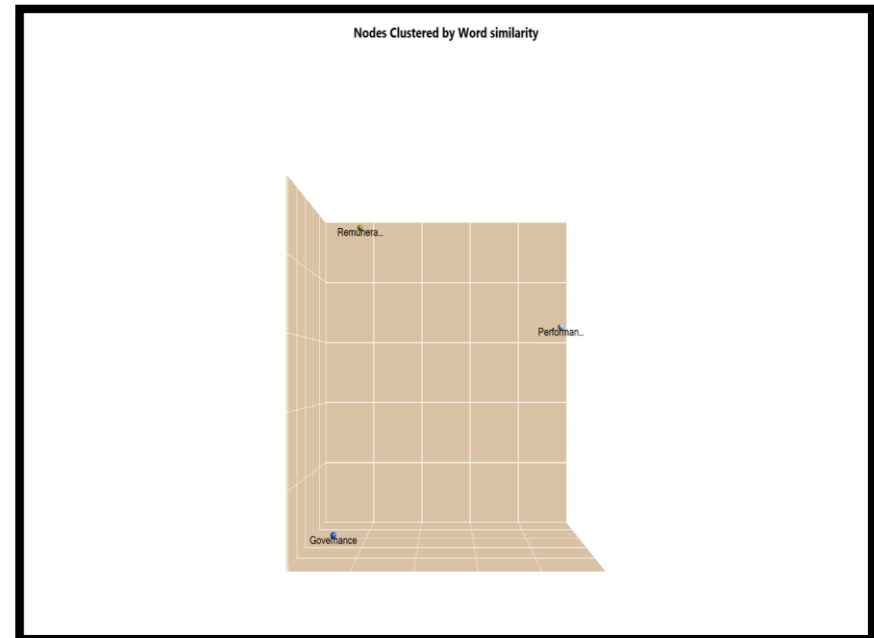


Appendix 6: Key Word Similarity Analysis

Node A	Node B	Pearson Correlation Coefficient
Performance	Remuneration	-0.04542
Governance	Performance	-0.0927
Governance	Remuneration	-0.12715



Horizontal Dendrogram



3D Cluster