

**USS External Fund Manager  
Responsible Investment Activity Report  
(July – December 2009)**

**Proxy Voting**

In the second half of 2009, the fund manager voted on 329 proposals at 39 company meetings worldwide. Of these proposals, 30 (9.1%) were voted against managements recommendations. The fund manager aims to vote at the shareholder meetings of all investee companies, wherever they are based.

**Engagement**

We met with associates from the following industry bodies, to discuss corporate governance or sustainability issues:

Norwegian Stock Exchange, US Securities and Exchange Commission.

We discussed governance, remuneration and potential voting issues with the following companies:

Altria Group, Anhanguera Educacional Participacoes S.A., BBVA, CSR, Diageo, DSG International\*, Gazprom, Goldman Sachs, JPMorgan, Marks & Spencer\*, Nippon Mining Holdings, Nippon Oil Corporation, Oracle Corp, Pernod Ricard, Rio Tinto, Unilever, Veolia Environnement\*.

*\* engagement discussed in more detail below*

We discussed sustainability and/or environmental issues with the following companies: Air Liquide, L'Oreal, Michelin, Scottish Power, Total, Vivendi.

**New chairman for DSG International**

Our investment analysts and managers met with John Allan, the new chairman of UK retail group DSG International (owner of electricals chains Dixons and Currys) in October. It gave us an opportunity to learn about his approach and philosophy on corporate governance. He talked about how he was getting to know the different parts of the business. We asked about the new strategy, the challenges of a new management team, sales culture and the relationship with the chief executive.

**Anticipating US climate legislation**

Several of our US-based analysts and portfolio managers invited five environment and energy experts to our Washington DC office in October to discuss issues facing US policy makers. This group included representatives of the Executive branch, the Legislative branch, industry and environmental policy experts.

The meeting provided an opportunity to discuss the likelihood of a legislative outcome to reduce greenhouse gas emissions. We asked about the technologies that currently exist and those that would be required to help meet greenhouse gas reduction targets. We also asked how important a carbon trading system would be in achieving emission reductions, and whether it could evolve without legislative support.

The meeting served to deepen our understanding of the US approach to combating climate change, which will have a significant impact on industries and our investment decisions.

**Marks & Spencer**

We met with the deputy chair of Marks & Spencer before the company's AGM in July, and again in September. The company has been under pressure in recent years following the decision to temporarily combine the roles of CEO and chair under the stewardship of Sir Stuart Rose. While investors do not doubt the merits of having Sir Stuart at the helm, the UK Combined Code on Corporate Governance recommends that the roles of CEO and chair of the board should not be held by one person simultaneously.

To raise this issue with investors and with Marks & Spencer, the Local Authority Pension Fund Forum (LAPFF) proposed a resolution at this years' AGM that the company should bring forward the appointment of a new chair from July 2011 to July 2010. We met with Sir David Michels (Deputy Chair of M&S) and then with Ian Greenwood (Chair of the LAPFF) ahead of the AGM.

In our meeting with Mr Greenwood, he explained the reason behind the LAPFF's proposal and the importance of the separation of roles at the top of the company. Its concern was that if a new CEO is appointed first, Sir Stuart would stay on longer as a non-independent chair. Their preference would be to separate the roles quickly and re-establish an independent chair.

We then met Sir David, who explained how Marks & Spencer intended to appoint a new CEO first and to keep Sir Stuart on as chair until 2011, by which time the company would be able to appoint a new chair and the transition would be complete. They felt that this would be a faster transition than appointing a new chair first, as it would allow Sir Stuart to step back from the day-to-day running of the business while still overseeing management.

This meeting with Marks & Spencer in July assured us that the succession issue was forefront for the company, and we felt that its approach was the best solution to an imperfect situation. We decided to support the board in its decision to appoint a new CEO first. Although this would lead to the company being in breach of the recommendations of the Combined Code for an additional year, we decided that it was the best strategy for moving towards new leadership for Marks & Spencer.

We held a follow-up meeting with Sir David Michels in September, in which we moved the discussion to remuneration. We asked specifically about the performance metrics utilised under their long-term incentive scheme. Currently the only performance criterion under the scheme is earnings per share (EPS). Long-term incentive schemes which apply only one measure of performance invite participants to make decisions that would inflate one measure of growth to the detriment of others. We do not suggest that this has been the case at Marks & Spencer, but we felt that it would be worth reviewing the long-term incentives ahead of the appointment of a new CEO. We suggested that an additional measure of return to shareholders such as return on capital might help to balance and incentivize long-term decision making.

### **Management changes in France**

At the end of September the French government announced its decision to appoint Henri Proglio, chief executive and chairman of Veolia Environnement, to the same two roles at utility group EDF. Veolia later issued a statement confirming that as a result of this departure they would separate the roles of chairman and chief executive, which is a move towards recognised good corporate governance practice. However, it then became clear that Mr. Proglio would continue to serve on the Veolia board in a non-executive capacity as chairman. Antoine Frerot would step up from his current role as head of the water division to become the new chief executive.

Our utilities analyst contacted the company to voice concerns over Mr. Proglio continuing as chairman while taking the new full-time role. He would not be independent and his continued presence would lead to excessive influence over the company, which is particularly significant as it competes with EDF in some areas. Our analyst felt that if Mr. Proglio was to become the combined chairman and chief executive of EDF, it would be better to have a clean break and appoint a new independent chair at Veolia.

The company acknowledged investors' concerns, but decided to retain Mr. Proglio as chairman to ensure continuity during the transition to the new chief executive.