CAD - 02143 cc Sir Adrian

Ackn'd (& sent copy?) Guardian article clarifying views on number of NED posts that an individual should hold).

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Dear Mr. Peace,

I am writing to you with some comments on the Draft Report of the Committee on the Financial Aspects of Corporate Governance.

It might be helpful if I describe briefly the background from which I am writing. I have nearly thirty years experience at board level of corporate governance in listed companies. I have experienced first hand, therefore, most of the modern development of self regulation in this field. Until 1980 I was (for fourteen years) one of a team of five people responsible for the UK based activities of Philips. In that period (and before in one case) Philips had majority interests in two listed British companies on whose boards I sat: my Philips portfolio included responsibility for Philip's interests in those companies and its relationship with other shareholders in those companies.

In 1980 I changed my relationship with Philips and, whilst continuing as a director in a non-executive capacity, made a start on a fresh career as a business consultant/non-executive director concentrating on listed companies which had run into difficulties of various kinds and young high technology companies which were seeking to move from a state of early funding to a trade sale or a listing. That situation evolved over time into one in which I am now regarded as a "professional" chairman. I am presently chairman of four listed companies. One of these is a substantial UK based engineering company which ran into some difficulties and agreed at the time of a rights issue to split the jobs of chairman and chief executive. Another is a moderately sized electronic instrumentation company operating mainly in the UK and the US. The other two are listed companies (one very small) which were rescued from disaster by differing forms of refinancing conditional upon the appointment a professional non-executive chairman. I am also non-executive chairman of the boards of two technology based drug discovery companies, one of which hopes to come to the London market within two years and the other of which is

likely to list on NASDAQ before coming to London in about four years. Both of these already behave as if they were listed companies. I am also connected with a number of other companies, mostly private, but I am non-executive vice chairman of a large listed company.

Since the issue by the Committee of the draft report I have discussed it informally with board colleagues in the first six companies I mention above and one aspect of the draft report has been the subject of formal consideration by the boards of three of the listed companies. I set out a summary of the views expressed to me and deal in some detail with the one point on which disagreement with the Committee has been expressed formally. I also add some comments of my own wearing my "professional chairman's" hat.

The general reaction to the draft report and proposed Code is that it is difficult to disagree with most of it but it is regretted that there is a perceived need for it. There is a fear that we might again have a situation in which the "bad" drives out the "good" by making necessary the introduction of formal "rules" to deal with the "bad" which inhibit the informality and flexibility which is inherent in much of the "good".

The concept of board unity is seen as most important and parts of the report are interpreted as implying that executive and non-executive directors have, qua directors, different responsibilities. Sub-paragraph 1.i of the terms of reference talks of "the responsibilities of executive and non-executive directors". Similarly there is a surprise at what appears to be a suggestion that non-executive directors, and they only, should be appointed by their fellows for fixed terms. It is felt strongly that the system whereby all directors, qua directors, retire by rotation and, if they stand, are re-elected by shareholders who will have elected/re-elected them in the first place is better. My personal experience is that this gives, and is known to give, a regular opportunity for all directors to assess the contribution of non-executive directors. The proper role of a chairman in canvassing opinion in the board in that context is well known and accepted. If he does not do it properly, he is the wrong chairman.

There is a feeling of resentment, in some cases quite strongly expressed to me by both by excutive and non-executive directors, that the Committee seems to imply that directors who are also employees of companies are incapable of distinguishing between the two roles and allow their hierarchical relationships and interests as employees to influence their judgement and behaviour in the board room. This is another matter on which I would like to express my own opinion. I

impress upon people that when they sit round the board table they do so as people with equal duties and rights and who, together, have a collective responsibility. I discourage strongly the notion that directors who are not also employees of the company are, other than in exceptional circumstances, more "independent" than those who are. This is one of the reasons that I dislike the suggestion that non-executive directors should be re-named independent directors. If they are to be distinguished from other directors, I would prefer to call them external directors.

My views on the above are welcomed in all the boards with which I am connected. Good companies are strongly management led in a framework of proper accountability. I have never had any difficulty in obtaining a ready acknowledgement from executive directors that a part of every board meeting must be devoted to the discharge of their duty to account to the board as a whole for what they have been doing. They understand that in this important accountability phase of a meeting the non-executive directors have an important role to play in the interests of the board as a whole. Equally, I have never had any difficulty in getting acceptance that there are areas which require careful handling in a way which recognises the possibility of conflict of interest: succession, buy-outs, takeovers, remuneration etc are well known examples. In my experience, the approach of all board members to their duties and the way the board should operate is almost always responsible and constructive. As a professional chairman I put a lot of effort into keeping boards united and am nervous of external interventions which could run against this. I am particularly nervous of cultivating the notion that the standards of behaviour anticipated by "the City" differ between executive and non-executive directors.

This leads onto a further point. Surprise has been expressed that the Committee has not said more about difficulties that can arise if the roles of chairman of the board and of chief executive of the company are in the same hands. The argument that I expected the Committee to focus on runs as follows. The chief executive is the person - and the only person - to whom wide responsibility for the management of the affairs of the company is delegated by the rest of the board. Usually other executive responsibilities at board level flow from sub-delegation by the chief executive. The chief executive is, and must be, accountable to the board as a whole for the way in which he discharges the responsibilities delegated to him. Although that is done formally at board meetings, it also takes place continuously and less formally through his relationship with the chairman. The chairman is the guardian of the interests of the board between board meetings (when

most of a company's life is lived!) and has a duty to use his judgement on whether something the chief executive proposes or contemplates reflects policy already approved by the board or requires consideration by the board. If the two roles are combined into one, then for much of a company's life an individual is accountable to himself and having a dialogue with himself - not easy for either of himselves! If the Committee is so concerned about conflicts of interest affecting the judgement of executive directors, qua directors, it is surprising that it is not much more concerned about the situation just described, particularly since there is such a wealth of evidence of the difficulties it can result in. Prescription is not argued for (there will always be proper exceptions and ideally movement from one pair of hands to two should be carefully managed over time) but a stronger warning is argued for.

The third point reflects a formal stance adopted after careful discussion under my chairmanship by the boards of three listed companies. Everybody agrees that effective audit committees are important and perform a very valuable function on behalf of the whole board in relation to all the matters mentioned by the Committee. However, it is strongly felt that such committees are committees of the whole board and that their constitution should reflect this. Specifically they should not be, nor appear to be, committees of the non-executive directors. The practice which the three companies I have mentioned wish to continue or adopt is one in which the audit committee works on behalf of and make recommendations to the whole board, is composed in the majority of non-executive directors (one of whom should be chairman of the committee) and from amongst the executive directors includes at least the finance director. The auditors should attend the meetings of that committee and should <u>also</u> attend meetings of the full board prior to approval and issue of half year and preliminary statements. The chairman of the board should make it clear on those occasions that the auditors are free to make any remarks they wish, to ask any questions they wish and to be asked questions by any board member. If that creates difficulties then either they are the wrong auditors or there is a serious malaise in that board and the relationship with the auditors. In either case the board probably has the wrong chairman.

Everybody understands that there may be occasions on which the auditors have a need to have a meeting with the non-executive directors - all of them! i.e. not just those on the audit committee. Normally auditors would make that need known through contact with the chairman of the board. If the chairman of the board also happens to

be the chief executive, such contact may not be effective and I suggest that it is in that case, and in that case only, that an audit committee consisting entirely of non-executive directors could be prescribed under the Code. The chairman of the audit committee would, under those circumstances, be the focus for the balancing power the committee has suggested. Curiously, in marked contrast to the text of the draft report, the present draft Code talks only of an effective audit committee and not of its composition. One further personal comment: I think one has to be careful about transplanting US experience into the UK scene. I have had some indirect experience of US boards. They appear to me to work in a very different way from the UK boards. This is illustrated by the fact that often the chief executive is the only "internal" member of the board. Under those circumstances their audit committees are necessarily comprised entirely of external directors.

I have three final observations of my own. Although the Committee's remit is confined to the financial aspects of corporate governance, I do not think one can usefully divide aspects of corporate governance in this way. I cannot think of a single aspect which is not "financial" in the ultimate analysis. I am therefore surprised that the Committee did not take the opportunity to say more about the role of the chairman of the board in the context of corporate governance and the importance of a professional approach to this role. Perhaps if the Committee had not regarded this as lying largely outside its remit, it would have thought more about what happens in between board meetings in the case of combined roles.

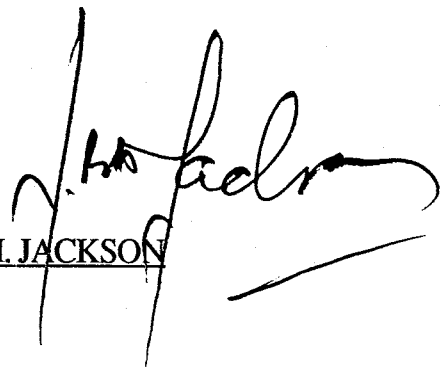
Secondly, quite a lot seems to have been said "obiter" about the number of different jobs an individual can do or should be allowed to do. Nothing is said about this in the draft report and it may not have been very helpful to have the draft extended unofficially in this way. Surely it is not a matter of numbers: can there not only be two "rules"? One is that nobody should take on, or be encouraged to take on, more than he is capable of doing properly by virtue of his personal capacity and demands upon his time. The other is that nobody should allow themselves to come into a situation or be encouraged to come into a situation, in which there is a serious potential conflict of interest between one role and another. With regard to the first "rule", I know well an individual with extensive business experience who would make an excellent external director of a listed company. However, he devotes so much of his time in the UK and overseas to the affairs of a single charity that it would be wrong for him to take on such a responsibility. How many roles can be performed by a single individual can only be

viewed on a case by case basis. With regard to the second, the other side of the coin is the cross fertilisation that companies can find useful.

My final personal comment is that, if we are to have a Code, I endorse strongly the idea that listed companies should be required under the terms of their listing agreements to declare the extent to which they comply with it and the reasons for the extent they do not. No listed company should be afraid of disclosing non-compliance for good cause but, on the other hand, it would be unfortunate if particular parts of the Code were the subject of wide spread rejection.

I hope all the foregoing is of some use to the Committee.

Yours sincerely,



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