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12 November 1992

Sir Adrian Cadbury
c/o Nigel Peace Esq
Secretary,
Committee on Financial Aspects of
Corporate Governance
P O Box 433
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London EC2P 2BJ

Dear Sir Adrian

It was a pleasure to be able to speak to you informally last week at the dinner given by Panel Kerr Forster about corporate governance and more particularly to hear the views of others; and your address at the CBI national conference on Tuesday, of course, picked up many of the threads that emerged in the course of the discussion over the dinner.

What I thought I might do is raise with you a limited number of points for you to ponder on (although I know that some of them are being taken into account in any event).

1. I enclose copies of memoranda from two US law firms, Fried Frank Harris Shriver & Jacobson and Skadden, Arps, Slate, Meagher & Flom dealing with new rules published by the US Securities and Exchange Commission about proxy rules and executive compensation disclosure requirements. They show the active role of the SEC in the United States in the activities of Boards of Directors (as well as shareholders) although in the context of a different corporate law. At dinner I raised the point about whether the question of

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corporate governance might become subject to legal regulation by statute, in the light particularly of the comments made by the chief executive of the Prudential about the failure, as he and others see it, of the regulatory system established through the Financial Services Act, 1986.

If a Securities Exchange Commission is established in the UK (or something equivalent to it) it seems to me inevitable that it will be given powers relating not just to those operating in the field of securities but also in relation to Boards of Directors and Shareholders; what is happening in the United States therefore may provide us with an illustration of what may come about in the United Kingdom over the next few years. That of course is quite separate from what may happen by reason of directives or regulations adopted by the EC (although I think that is less of a risk than the adoption of change in UK domestic law and the system of regulation of the securities markets and companies generally).

2. If compliance with the Code of Best Practice is made a term of the listing agreement, it will in effect give the Code legal enforceability at least as between the company on the one hand and the Stock Exchange on the other. In the Datafin case which I was involved with when the Takeover Panel were taken before the High Court on judicial review, one of our arguments was that because the listing agreement requiring compliance with the Takeover Code, the Takeover Code was indirectly given the force of law, at least as between the company on the one hand and the Stock Exchange on the other such that the Panel became subject to review in the courts. This was to counter the argument that the Panel was not a creature of law, but of informal agreement under the auspices of the Bank of England and others and therefore outside the jurisdiction of the Courts.

   To the extent that a listed company obliges itself (and its board) to comply with the Code therefore the duties owed by directors may be correspondingly increased and the potential for liability therefore made greater.

3. A third question relates to the function of auditors; under the Code more responsibility will be put on auditors. Necessarily auditors are, today, faced with increasing conflicts of interest for on the one hand they provide the audit service and on the other they seek to sell management consulting (including taxation) services to their audit clients (as well as others); the consultancy services may from time to time cause real conflicts between the accounting firm's role as an adviser and as an auditor. The proposal that the auditors should have some responsibility for reporting on compliance with the Code may go to increase the areas for potential conflict between the two roles. Certainly I have come across situations where advice being given by accounting firms in the consultative capacity impacts on their role as auditor; in times of recession it is possible that the firms may be prepared to disregard these types of conflicts.

This of course is all part of the wider debate, going on in the EC as well as in the UK about the role of auditors and more particularly whether the major accounting firms should effectively hive off their audit operations so that they are separate and distinct from their other operations and particularly their consulting operations in order to avoid what may be real conflicts of interest.

4. The cost of compliance with the Code may be more substantial than is expected, and may cause management time to be devoted to non-productive matters, particularly at times of difficulty when the actions of the directors will come under closest scrutiny. I am sure that those willing to act as independent directors will only be willing to do so in return for substantially higher fees than are currently paid so that that will undoubtedly be an extra cost.

I hope that you find these comments helpful and if you think that any of them deserve discussion, no doubt you will let me know.

Yours sincerely
Christopher Haram