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9 March 1995

Anne Simpson
Joint Managing Director
PIRC
Crusader House
145-157 St John Street
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Dear Anne,

Many thanks for your letter about the Conference on 17th March. You have assembled an interesting panel of speakers and I am sure that we will have a thoroughly worthwhile day. I am afraid that I will have to leave just before the end as I have to attend a dinner in Staffordshire, wearing my High Sheriff's hat.

I will not require any audio-visual equipment and I will keep to 20 minutes. I hope to find the time over the weekend to do some notes which I will then fax to you.

We had a useful discussion at our Corporate Governance Committee on the letter from Alan. Jonathan and I felt that the best way of responding to it would be to find a moment on the 17th when we could run over the Committee's views. I will touch on the issue of independence in what I have to say, since it is an area for judgement.

What I think is important, given the comprehensive list of criteria which PIRC takes into account in coming to a conclusion on independence, is how you relate independence to compliance with the Code. Your criteria go wider than any that I know of, either here or in the United States. If you base non-compliance with the Code on the independence issue, you have to make it quite clear how you have arrived at this judgement and that it is non-compliance on your terms which could be at variance with the interpretation by others of Para 4.12.

I attach an extract from a talk I gave to the Institute of Advanced Legal Studies which makes the point that, in my view, the issue is open to external judgement but, that for that judgement to be made, we need a more detailed account by directors of their interests than we currently receive. Unfortunately, the last sentence of Para 4.12 is not part of the Code but it is one to which I attach considerable importance. I do hope that you can help to bring pressure to bear on companies to be more informative about those whom they are putting forward as board members.

I look forward very much to seeing you on Friday.

With best wishes

Alan



21 February 1995

Sir Adrian Cadbury
Chairman
The Committee on the Financial Aspects
of Corporate Governance
c/o The International Stock Exchange
London EC2N 1HP

Dear Sir Adrian,

**Compliance with the Code of Best Practice
and Independence of Directors**

At Jonathan Charkham's suggestion, we are writing to request formally that the Committee considers a matter which has arisen and which, in our view, has very great importance for the role of shareholders in the corporate governance process.

As you know, we provide a Corporate Governance Service for institutional investors in the UK and the USA. In our Reports on companies we include voting advice based on our published Guidelines and also our independent analysis of compliance with the Code of Best Practice. In doing so, we consider we are helping institutional investors fulfil their responsibilities for ensuring compliance with the Code as envisaged in the Committee's Report.

One of the most important areas where we apply our analysis is the issue of non-executive directors' independence. We very much welcome the clear guidance in the Committee's Report about the need for non-executives to be in a position to take an independent view to that of the executive directors. Accordingly we have developed criteria which we use in assessing independence. These criteria were set out in our Shareholder Guidelines 1994, which were sent to all FT-SE A All Share Index companies in March/April 1994. I attach a copy for your reference.

Our assessment of independence contributes to our view on whether companies comply with the Code of Best Practice. Our practice has been to state our opinion on compliance in our Corporate Governance Reports.

We have been aware of the statement in the Report that "It is for the board to decide in particular assess whether this definition [of independence] is met". However, our opinions on independence and compliance are not intended to supersede those given by the directors. Rather, they represent an independent assessment which shareholders may use to inform their analysis of corporate governance.

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A major company has now challenged whether we can make an assessment of independence which differs from that of the Board, and whether we can therefore make an assessment of compliance with the Code of Best Practice. The company's view is that we "are not at liberty to say that the company does not comply with the Cadbury Code, since the Code itself entitles the Board to make the determination...." The company also states that the Board has considered the question of independence in coming to its view that the company complies with the Code of Best Practice.

At no stage are we suggesting that the directors have acted in bad faith in arriving at their view. However, it appears to us that there is room for more than one opinion on matters of independence and therefore compliance.

PIRC believes that if Boards have sole determination of whether their non-executives are independent, then shareholders are hamstrung in their ability to exercise their responsibilities in the corporate governance process. Board are in effect acting as judge and jury and may make any determination they like. This will stifle debate on this important area and render the Code of Best Practice considerably less effective.

We hope that the Committee can treat this issue as one of the utmost importance. It not only has ramifications for our approach to corporate governance on behalf of our clients, but more importantly, for the credibility of the Code itself.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Alan MacDougall", written in a cursive style.

Alan MacDougall
Joint Managing Director

The last issue on the subject of outside directors which has been raised in relation to the Report concerns the way in which independence is to be defined. The Committee has set out a simple guideline and put the responsibility for applying it where it belongs. That is to say that it is for boards to come to their own conclusions on the matter and to carry their shareholders with them. But if shareholders are to be in a position to judge how far directors are independent, they will need a fuller account of directors' interests than the contract-based declaration laid down by the Companies Act. The issue of independence turns to a considerable extent on how directors are nominated and appointed. The slightest whiff of patronage undermines an outside director's independence from the outset. This is why the Report stresses the importance of having a formal selection process and involving the whole board.

The broad issue to which all these points concerning the role of directors on unitary boards raises is what is the longer-term future of the present unitary board structure.

Chairman and Chief Executive

The criticism that the Committee's Report had not made the separation of the two top jobs mandatory has been referred to earlier. The Committee did not specifically require the posts of chairman and of chief executive to be separated, although it made it clear in the Report, as opposed to the Code, that in principle they should be. Prescription in this matter is undesirable for a number of reasons. First, all companies are different, as are all chairmen and all boards, and it would be contrary to observed experience to say that combining the two roles can never work successfully, given appropriate safeguards. Secondly, there is more to the governance structure than the positions of the chairman and of the chief executive. What matters is that the board structure, taken as a whole, should contain checks and balances which the shareholders consider adequate. Finally, meeting the Committee's recommendation, that there should be a clearly accepted division of responsibilities at the head of a company, is a sterner test of the genuine separation of powers than simply having to give two directors different titles.