

## FINANCIAL REPORTING COUNCIL

### CONSULTATION ON THE REVISED UK CORPORATE GOVERNANCE CODE

1. The comments below are from Pinsent Masons LLP, a top 15 UK full service commercial law firm, acting for private and public sector clients worldwide. They have been drafted by Martin Webster, the head of our corporate governance unit within our Corporate group which comprises 43 partners and more than 100 other lawyers. The latest Hemscott guides (February 2010) put us second among law firms for the number of fully listed clients and first for AIM clients. The firm was voted Legal Firm of the Year at the Real Business/CBI FDs' Excellence awards in May 2009.
2. We support your proposed changes to the Code. In particular, we agree with your approach of making relatively limited changes and restricting them to those principles and provisions of the Code which recent experience suggests can usefully be amended. Our detailed comments below are confined to two areas where you have asked for views on the issues you have raised.

#### Frequency of director election

3. You propose that companies subject to the Code should either move to annual re-election of the Chairman and continue to submit all other directors to election at the first AGM after their appointment and to re-election thereafter at intervals of no more than three years; or that they should submit all directors to annual re-election by shareholders. You ask for views as to which of these options should apply. Whichever option is chosen would be a Code Provision (to be applied on a comply or explain basis) relating to Main Principle B.7 ("All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance").
4. The following is a selection of the arguments in support of annual re-election of all directors.
  - 4.1 If directors are to be appraised each year (as required by Main Principle B.6), submitting directors for annual re-election is a natural corollary to the appraisal process. The fact of annual re-election will add emphasis and relevance to the appraisal process (and give it a fixed timetable requiring completion in advance of finalising the AGM notice). The appraisal process may occasionally lead to a director agreeing to stand down and the prospect of annual re-election provides a prompt for such a decision.
  - 4.2 Directors are answerable to shareholders and annual re-election is a reminder of that principle which can encourage greater engagement and dialogue with shareholders (as required by Main Principle E.1).
  - 4.3 Those companies which have already moved to annual re-election of the whole board do not appear to have suffered from any of the disadvantages cited against the proposal.
  - 4.4 Shareholders representing 5% of a company's paid up share capital carrying the right to vote can, in any event, convene a general meeting to remove one or more directors (or can require that a resolution to the same effect is put at an AGM) and they need only a simple majority of the votes cast at the meeting to achieve that end. Annual re-election of all directors only gives shareholders a further opportunity to do something which they can already accomplish.
  - 4.5 There are few examples of directors being voted off boards when they come up for their triennial re-election under current rules. There is no reason to believe shareholder militancy will increase because there are additional opportunities at each AGM.

5. And the following are some of the arguments which may be made against the proposal.
  - 5.1 Submitting all directors to annual re-election leaves boards vulnerable to hostile activist investors. For example, in preliminary skirmishing prior to a possible takeover, when a board may perhaps have refused access to the company's books, a hostile shareholder able to command 29.9% of the votes may well have enough to unseat a board if other shareholders cannot be motivated to support the directors. Minority shareholders may therefore be able to achieve their ends without majority support.
  - 5.2 Submitting a third of directors to annual re-election limits the risk to the company if the vote is lost; submitting all of them risks losing the entire board at one go, which will seldom be in the interests of the company.
  - 5.3 The combined effect of the two previous points is to create uncertainty for the company. Boards will become defensive and reluctant to sacrifice short term advantage in favour of the long term.
  - 5.4 Shareholders have the ability to remove directors in any event (see paragraph 4.4 above) so there is no need to give them a further opportunity.
  - 5.5 There is no great call from shareholders for annual re-election of directors. Such a proposal should only become a Code Provision if there is a demonstrable wish for the change from companies or shareholders. No such demand currently exists.
6. We believe these arguments for and against are finely balanced. Our conclusion is that there is no compelling reason why the Code should be prescriptive on this point. It may well be desirable for boards to be encouraged to consider annual re-election as a corollary to annual appraisals, but without elevating this to the status of a Code Provision carrying an obligation to comply or explain. For the time being, companies should be left to decide whether to move to annual re-election or to retain a three year cycle of re-elections. Companies and their investors should be encouraged to enter into a debate on the subject and time should be allowed to see how practice develops.
7. We note also that Sir David Walker seems to have reached a similar conclusion (see paragraph 4.25 of his Report). We do not think there is a sufficiently compelling argument for the FRC to go further than Walker in amending the Code.

**Should disclosures required by the Code appear in the annual report or on a website?**

8. You ask in paragraph 15 of your consultation document whether companies should be given the option of making various disclosures required by the Code in their annual report or on the company's website (as permitted by DTR 7.2.9).
9. We believe it is useful to have all such disclosures appear in the annual report along with all the other information required in that document. If corporate governance disclosures were taken out of the annual report and appeared elsewhere, shareholders and other interested parties would be looking in a number of different places for allied information. Companies should be encouraged to include these disclosures on the corporate governance pages of a website but they should not be permitted to exclude them from the annual report.

If you have any queries on the points made above, or require any further comment, please do not hesitate to contact Martin Webster on 020 7418 9598 or [martin.webster@pinsentmasons.com](mailto:martin.webster@pinsentmasons.com) or at Pinsent Masons LLP, CityPoint, 1 Ropemaker Street, London EC2Y 9AH.

**Pinsent Masons LLP**

5 March 2010