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Dear Chris

### **Consultation on the Revised UK Corporate Governance Code**

Tesco welcomes the opportunity to respond to the FRC's consultation on the revised UK Corporate Governance Code. We submitted responses to the previous consultations in June and October last year and expressed in those responses the view that the "comply or explain" approach works well and provides an appropriate framework for corporate governance. We are therefore pleased that the FRC has retained this approach as the foundation for the revised Code.

We also welcome the fact that the FRC is not proposing major changes to the Code and its view that a flexible approach remains the most appropriate way of raising standards of corporate governance in listed companies. We believe that it is appropriate only to amend the Code where it is appropriate for all listed companies.

We are generally supportive of the changes which are being proposed to the Code, but there are several areas in relation to which we have concerns. We have focussed on these areas in our response, rather than commenting in detail on each proposed change to the Code.

### **Re-election of Directors**

We do not support annual re-election of either the chairman or all directors. We agree with the Main Principle that "all directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance", but think that the existing three yearly rotating renewal for board directors works well. A move to annual election for either the chairman or all directors would make it more difficult to encourage external directors to take a long-

term approach in their role in the company. It takes several years for a new director to get fully up to speed following appointment, and the prospect of being voted out soon afterwards is likely to prove a disincentive to people agreeing to become directors, a problem in an environment where it is already becoming more difficult to attract good quality non-executive directors.

Furthermore, we think that providing just for the chairman to be re-elected annually is inconsistent with the principle of a unitary board, as well as the legal position, which makes all directors jointly liable for the management of the company.

We don't feel that the proposed annual re-election rules would provide much additional benefit to shareholders, given that they already have powers to call for the removal of one or more directors under the Companies Act.

We also believe that there is a very real risk of abuse of the process, with activist shareholders using the opportunity to vote against re-election purely as a means of registering their dissatisfaction with specific issues relating to the running of the company, while not actually seeking the removal of a director for reasons relating to that director's performance.

Furthermore, while it is unlikely that such voting against re-election would often be so substantial as to result in a director being removed from office, even a relatively low vote against re-election (of say 10-15%) would be likely to be seized upon by the media and turned into a major story, leading to a possible undermining of the director's standing and reputation.

We also have a concern about unengaged fund managers increasingly delegating voting decisions, either internally to governance departments or through an unquestioning following of the recommendations of shareholder representative bodies, neither of whom may be fully informed about the companies against which they are voting.

We understand that shareholders may want the ability to influence boards quickly and directly, but we believe this is far better addressed through face to face engagement with the company rather than voting.

We support the proposed emphasis on greater shareholder engagement with companies in the new Stewardship Code, and look forward to responding to the separate consultation paper on it.

In addition to the above arguments,

### **Board Evaluation**

We do not support a move to obligatory external board evaluations every three years. While many companies (including Tesco) do in practice engage external consultants to assist with the board evaluation process every few years, we do not think that it should be a requirement to do so every three years.

The board should be able to assess, on the basis of the facts at the relevant time, whether an external evaluation is appropriate in a particular year. In a year where there have not been major changes to personnel or governance processes, for instance, a board may justifiably feel that it is not worth incurring the substantial expense and time commitment of an external evaluation and may decide that an internally-managed process is more appropriate. Companies may also feel that the presence of external evaluators will hamper or distort normal and full boardroom discussion, or cause confidentiality problems.

Clearly if shareholders feel that an external evaluation is overdue, they can make that clear to a company through engagement, and the company is likely to take those views into account. Rather than including in the Code a prescriptive requirement for an external evaluation every three years, it may be more appropriate to require the board to consider each year whether it is appropriate to conduct an external evaluation of its performance.

### **Independence**

We welcome the recognition by the FRC that the existing Code's emphasis on the importance of independence has made it more difficult to achieve the right mix of skills, experience and objectivity in the composition of the board. We therefore support the newly modified Main Principle that the Board and its committees should "consist of directors with the appropriate balance of skills, experience, independence and knowledge of the company" to enable it to discharge its duties and responsibilities effectively.

We believe, however, that the continuing reference in Code provision B.1.1 to "nine years" is too prescriptive, particularly when trying to balance independence criteria against the need for experience and expertise. We would therefore support a reference to "length of service" more generally rather than to "nine years" specifically, as one of the factors to be taken into account by the board when addressing a director's independence.

### **Disclosure**

We are concerned that provision C.1.2 (*The directors should include in the annual report an explanation of the basis on which the company generates revenues and makes a profit from its operations (the business model) and its overall financial strategy*) seems to go wider than the Business Review provisions in the Companies Act 2006, and we believe that this issue should be addressed in an amendment to the Companies Act, if appropriate, rather than through the Code. It does not seem something that companies should be required to address in their corporate governance statements.

### **Apply or Explain**

We would reiterate our view, expressed in our previous responses, and supported by the CBI and GC100, that it would be appropriate to move from

the current “Comply or Explain” framework to one where “Apply or Explain” equals compliance. We believe that this is a much clearer definition, is less subject to manipulation by the media and prevents voting agencies from continuing to use non-compliance as a test in their governance reports without having properly considered an explanation.

### **Directors’ time commitment**

We are pleased that the FRC has not sought to be prescriptive on specific time commitments for directors, or to impose minimum time commitments.

### **Risk**

We believe that the current risk model, with the board as a whole responsible for determining risk appetite and articulating the risk profile of a company, and management being responsible for managing risk and internal controls, works well. Whilst large and complex financial services businesses might benefit from a separate risk committee, we are pleased that the FRC has recognised that businesses in other sectors already face different risk profiles and companies are already required to apply robust and thorough risk management processes in the running of their business. We therefore support the FRC’s decision not to include a Code provision recommending that every listed company have a separate risk committee.

We hope that this response will be helpful to your work in reviewing the Code. Please do not hesitate to contact us if you have any queries in respect of this response or would like to discuss any of the points we have raised further.

Yours sincerely

Jonathan Lloyd

**Company Secretary**  
**Tesco PLC**