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Corporate Governance Unit  
Financial Reporting Council  
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London  
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25th June 2007

Dear Mr Hodge

### **Review of the Impact of the Combined Code**

We are writing in response to the FRC's request for views from listed companies, directors, investors and other interested parties on their experience of implementing the Combined Code.

The Commerce & Industry Group is a recognised Law Society Group run by in-house solicitors – who give their time freely – to provide services to its members. The C&I Group has established a dedicated Committee to deal with a range of corporate governance issues. The members of the Committee (who are listed in the Appendix to this letter) are drawn from a cross section of organisations, including some listed companies.

The Committee has published two documents which elaborate on some of the ideas discussed in this letter: "A fine line - Further guidance to In-House Lawyers in England and Wales on ensuring good corporate governance in your organisations", 24th July 2006 and "Blowing the Whistle – Guidance to In-house Lawyers in England and Wales on Whistleblowing and Corporate Governance", 20th April 2007. Both publications are available on [www.cigroup.org.uk/Regions\\_corp\\_gov.asp](http://www.cigroup.org.uk/Regions_corp_gov.asp).

The views and opinions expressed in this letter are not necessarily to be attributed to the organisations represented by Committee members.

We agree that, overall, the Code is having a positive impact, contributing to improvements in corporate governance practice and disclosure and greater

engagement between boards and shareholders. However, we believe that the following improvements could be made.

## Paragraph A.5 – The role of the Company Secretary

This paragraph provides a useful summary of the important role of the company secretary in ensuring that a company has good corporate governance. It is based on paragraphs 11.29 to 11.34 of the Higgs Report. However, it omits an important recommendation contained in paragraph 11.30 of the Higgs Report, namely “To ensure good communication within the board and its committees, it is good practice for the company secretary, or their designee, to be secretary to all board committees.” The reason the company secretary needs to be secretary to all board committees is to enable them to provide well-informed advice on all areas of the organisation’s corporate governance, and to assure all stakeholders that corporate governance failures are not being hidden away. The omission of this important recommendation from the Code raises the possibility that some companies will conclude that the company secretary could be excluded from one or more of the board committees, and that an unqualified person could instead act as their secretary<sup>1</sup>. The risk is greatest with the Nominations and Remunerations Committees, where there may be pressure from the CEO or other executive directors to exclude the company secretary because of the highly sensitive discussions that these committees may have about current or proposed directors and senior managers. However, the Nominations and Remunerations Committees are arguably the committees which are in greatest need of the company secretary’s independent and expert advice on corporate governance, and excluding the company secretary from these committees deprives them of an overview of all the corporate governance issues facing the organisation.

*We therefore suggest that the following sentence should be added to paragraph A.5: “To ensure good communication within the board and its committees, it is good practice for the company secretary, or their designee, to be secretary to all board committees.”*

## The In-house Legal function

Most listed companies have an in-house legal function, which in practice plays an important role in promoting good corporate governance within the companies. When a corporate governance failure occurs, the in-house lawyers are often criticised more or less explicitly for not preventing the failure. For example, in the recent Shell case (over-statement of their oil reserves), one of the remedial actions that the FSA required was “enhancement of the Group legal function to improve the ability of Group management to benefit from appropriate legal advice concerning potential corporate governance, reporting and disclosure issues”<sup>2</sup>. These cases suggest that one of the key challenges for UK in-house lawyers, if they are to act as corporate governance “gatekeepers”, is to gain sufficient status and authority within their organisations, so that they know and understand what the organisation is doing, and can influence the management’s decisions. Part of the

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<sup>1</sup> Section 273 of the Companies Act 2006 sets out the minimum qualifications of the secretary of a public company.

<sup>2</sup> FSA Final Notice, dated 24 August 2004.

problem for UK in-house lawyers is that the role of advising on legal and regulatory matters tends to be split between the company secretary (advising the Chairman and the Board) and the head of legal, and the latter role may in turn be split – with a specialist head of compliance handling regulatory issues. Even when these roles are held by the same person, they may report to different individuals in different capacities (e.g. the chairman in their capacity as company secretary and the CEO in their capacity as head of legal). “Divide and rule” may be the result, if not the intention.<sup>3</sup>

The Code is completely silent about the role of the in-house legal function in promoting corporate governance in listed companies, as it apparently assumes that the company secretary is able to provide all the advice on corporate governance issues which a listed company requires. However, cases like Shell demonstrate that listed companies may face corporate governance issues that go far beyond the internal workings of the board and its committees which are the normal province of the company secretary.

*We suggest that the Code should include a commitment to ensure that any listed company has adequate internal and/or external resources and processes to enable it to identify and manage the legal and regulatory risks faced by the company.*

#### Paragraph C.3.4 – Whistleblowing<sup>4</sup>

A key part of any organisation’s corporate governance arrangements should be to encourage its staff to report any serious malpractices that they observe, first to their superiors within the organisation and, if that avenue fails or is for some reason not available, to external authorities. Without such reporting, the organisation’s board and senior management may not be aware of malpractices committed at lower levels of the organisation, the board may not be aware of malpractices committed by the senior management itself, and (if there is a complete breakdown of corporate governance in an organisation) the organisation’s owners, creditors, regulators, or other stakeholders may not be aware of the board’s own complicity in the malpractice.

The whistleblowing legislation (the Public Interest Disclosure Act 1998 (“PIDA”)) does not protect individuals in all circumstances where they have legal or ethical obligations to report their concerns. Compliance officers and money laundering reporting officers are particularly exposed, because they may have to make external disclosures to the Financial Services Authority and the Serious Organised Crime Agency respectively, and this was not contemplated when PIDA was drafted. We have recommended that PIDA should be amended to protect individuals who are

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<sup>3</sup> This paragraph draws upon the editorial regarding Whistleblowing contained in Law and Financial Markets Review, Vol 1, Number 3, May 2007, published by Hart Publishing.

<sup>4</sup> We have discussed these issues in greater detail in “Blowing the Whistle – Guidance to In-house Lawyers in England and Wales on Whistleblowing and Corporate Governance”, 20th April 2007, available on [www.cigroup.org.uk/Regions\\_corp\\_gov.asp](http://www.cigroup.org.uk/Regions_corp_gov.asp).

complying in good faith with their obligations under separate regulations to make external reports.

If an in-house lawyer is told about a malpractice in the course of providing legal advice to the company, and the subject matter attracts legal privilege, the in-house lawyer's disclosure of it is unlikely to be protected by PIDA. In-house lawyers will be worse off in this respect, than if they had not been legally qualified, as similar information given to company secretaries or compliance officers who are not legally qualified would not be privileged. This would apply even though the in-house lawyer's disclosure of the malpractice is made within the organisation (for example, to the board). We have recommended that this defect should also be amended by legislation.

These defects in the whistleblowing legislation are unfortunate, as they may discourage precisely those staff (compliance officers, money laundering reporting officers and/or in-house lawyers), who have key corporate governance roles below the board level, from raising their concerns about malpractices within the organisation.

Paragraph C.3.4 of the Code contains the only reference to Whistleblowing in the Code. *We suggest that the Code should contain a more positive and prominent statement that listed companies should adopt and implement an effective Whistleblowing policy, should encourage whistleblowing which is done in good faith, and should give assurances to their in-house lawyers and other control staff that they will not be victimised if (acting in good faith) they raise concerns with the board about possible malpractices within the company or they report possible malpractices externally in accordance with their normal roles in the company.*

#### Summary of our suggestions

1. The following sentence should be added to paragraph A.5: "To ensure good communication within the board and its committees, it is good practice for the company secretary, or their designee, to be secretary to all board committees."
2. The Code should include a commitment to ensure that any listed company has adequate internal and/or external resources and processes to enable it to identify and manage the legal and regulatory risks faced by the company.
3. The Code should contain a more positive and prominent statement that listed companies should adopt and implement an effective Whistleblowing policy, should encourage whistleblowing which is done in good faith, and should give assurances to their in-house lawyers and other control staff that they will not be victimised if (acting in good faith) they raise concerns with the board about possible malpractices within the company or they report possible malpractices externally in accordance with their normal roles in the company.

If you would like to discuss any of our suggestions, please feel free to call me on tel. 0870 220 7380.

On behalf of the committee, we thank you for the opportunity to submit our views and hope that the FRC will find them helpful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Simon Welch', is displayed on a light grey rectangular background.

**Simon Welch**

On behalf of the C&I Group Corporate Governance Committee

## Appendix – Members of the C&I Group Corporate Governance Committee

Simon Welch, West Bromwich Building Society, Chairman  
David Haig, Banque AIG London Branch, Deputy Chairman  
Nina Barakzai, Towers Perrin, Forster & Crosby Inc.  
Maxine Chow, LGC Group Holdings plc  
Lola Emetulu, Vodafone Group Plc  
Bruce MacMillan, Dell EMEA  
Jean-Paul Rabin, The Capita Group Plc  
Ian Scolah, Morley Fund Management Limited  
Maria Seale, Transport for London  
Vanessa Sharp, KPMG LLP  
Richard Tapp, Carillion plc  
Simon Graham, Wragge & Co LLP  
Colin Leaver, Simmons & Simmons  
Roger McCormick, London School of Economics