Balfour Beatty

Balfour Beatty plc
Group Head Office

130 Wilton Road
London SW1V 1LQ

Tel 020 7216 6800
Fax 020 7216 6950

www.balfourbeatty.com

Direct Tel: 020 7216 6968
Direct Fax: 020 7216 6940
E-mail: mark.peters@balfourbeatty.com

Our ref: MDP/kw
Your ref:

29 May 2009

Mr Chris Hodge
Corporate Governance Unit
Financial Reporting Council
Fifth Floor
Aldwych House
71-91 Aldwych
LONDON WC2B 4HN

Dear Mr Hodge

Response to FRC's Review of the Effectiveness of the Combined Code (the "Code")

Thank you for inviting us to participate in the review process for the Combined Code.

The subject of Board effectiveness is a very complicated one. We believe it is important that any actions taken as a result of this Code review are properly thought through, and not a knee jerk reaction to the recent crisis of confidence in the banking and financial sector and in response to the political and media storm this has created.

Context:

We consider that the 'comply or explain' model is not broken and works well when compared against a more rigid regulatory regime. The recent upheaval in financial services can be attributed to a number of factors and we do not believe it is prudent to identify the Code or performance of non-executive directors as the principal influencing factors in this regard. The Code has, in our view, been operating with good effect over a number of years in many sectors and there has been significant progress over this time in promoting good corporate governance, enabling transparency and challenging boards to confront issues. The principles-based mechanism provided by the Code and the other governance codes which have been introduced since, have helped to create a background against which board behaviours have been able to change in an environment which is not perceived as 'box-ticking'. Corporate reputation is at the core of what a company needs in order to build on its success and the Code has played a significant role in helping boards to achieve this.

What has worked well?

Although the Code has promoted transparency and encouraged behavioural changes in the boardroom, there are a few areas where further enhancement would be justified. Listed

companies have, in the main, adopted the Code principles and provisions in their entirety, but where this is not the case, it is important that companies are permitted to retain the flexibility of the 'or explain' option as there may be legitimate business reasons so to do.

What we should be discouraging is compliance for compliance sake, where boilerplate disclosures are made which stick to the letter of the Code, but are not necessarily reflecting its spirit.

There should be an overt acceptance that 'one size does not always fit all' and companies should feel able to 'explain' if this suits their individual businesses more appropriately.

(i) Board Effectiveness:

There are no parts of the Code which we consider have inadvertently impacted on board effectiveness and, to the contrary, we believe that the Code has helped boards to undergo behavioural changes to the ultimate benefit of shareholders.

(ii) Risk:

It is in the area of risk that the Code could perhaps lay greater emphasis. There is no reason why there should not be an overt encouragement on boards to embed risk within their business objectives and strategy, having established the risk appetite and parameters within which the company is able to operate, although this is currently provided in the Turnbull Guidance. There is merit in consolidating the obligations in one place, but we do not believe this is strictly necessary.. It is important though that the determination of risk and its management within a business is the recognized province of the directors and nothing should be done to restrict the ability of a board to fulfil its obligations in this area. The Turnbull Guidance in itself addresses this important issue extremely well. Every business is different, and the board need flexibility to determine the processes with respect to risk management which are most appropriate for its business as well as being able to actively consider value creation opportunities.

(iii) Comply or Explain:

The 'comply or explain' mechanism is generally working effectively and the quality of disclosures and the level of transparency has improved considerably over the years. Perhaps, in part due to this, there has not been any particular evidence of any increased level of investor engagement (except around remuneration matters and a few high profile interventions). Some investors have persisted in publishing their own corporate governance codes, in spite of earlier assurances that the Code would replace these. It can be confusing to have so many different codes in place and, if institutional investors could be encouraged to embrace the Code itself, and not seek to impose their own requirements which can be more prescriptive, this would be a helpful step forward.

(iv) The Board:

We consider that the unitary board is still the most effective model. All directors have the same responsibility to the company and its shareholders irrespective of whether they are executive or non-executive. The Code might remind them explicitly of their duty to act in the best interests of shareholders and that, as directors, they are one step down from the shareholders, as opposed to one step up from management.

(v) Training and Evaluation:

Training and evaluation are two key ingredients in helping the board to operate to its best effect. In the case of **training**, further attention should be given by companies on what training is given to their directors and, in the case of non-executive directors specifically, what help is provided to enable them, not only to understand their responsibilities, but also to understand better the company itself, its business, the markets in which it operates, the competitive environment and the risk profile/appetite. To supplement, there should be enhanced disclosure in the corporate governance report each year, on what training has been provided. It is essential though that this not becomes prescriptive or inflexible. It is for boards to decide what is appropriate for its directors and this will depend on the type of business and on the composition of the board itself.

(vi) Board Evaluation:

Although it is justified to expect annual assessments of directors, the full board evaluation would be more usefully conducted, perhaps every three years, and external evaluation from time to time should be encouraged. More frequent assessments can lead to 'box-ticking'. However, it should not be imposed upon a company what level or type of board evaluation exercise is acceptable. As with training, there needs to be more disclosure in the corporate governance report on what evaluation has been carried out, whether it has been conducted using external assessors and what learnings/actions have been taken.

Ensuring all directors (but particularly non-executives) are given the opportunity to make business visits and to get a fuller understanding of the risks which exist within the organization and how these might impact on strategy, are practices which effective boards should be seeking to encourage. It is important though not to impose a prescribed approach but to allow boards and individual directors to determine what is required and to then report to shareholders.

The hoped-for expansion of the non-executive director 'gene pool' has not really been followed through and diversity still remains an issue on many boards. It is essential that the quality of candidates remains high and this should be driven by the requirements laid down by nomination committees.

The Remuneration Committee:

The remit should also include the review of any incentive schemes where they could influence the company's risk profile, irrespective of whether the executive directors participate or not. Although remuneration committees rely in part on the services of their external and internal advisers, the reducing number of 'blue chip' remunerations advisers is a cause for concern. There has already been a preponderance of similarly constructed incentive schemes over the years due, in part, to the very few firms who are able to advise remuneration committees.

Board Support:

The company secretariat should be appropriately resourced and its effectiveness considered as part of the board evaluation process, so that the board can consider whether the company secretariat and the secretariat team, is adequately resourced to meet the needs and expectations of

the board. The secretary should take an active role in establishing, in consultation with the chairman, whether the board has the information it needs from management and the business to carry out is duties effectively and to help ensure that the non-executive directors are able to effectively contribute at board meetings. The secretariat should take the lead in organizing a programme of training each year, not only covering governance issues, but also to enable the non-executive directors to gain a full understanding of the company, its markets, the competitive environment and the risk profile.

Conclusion:

In conclusion, we would certainly support the continuation of the 'comply or explain' mechanism and the unitary board.

In our view there is no need to introduce any more prescription within the corporate governance codes themselves as companies must maintain the flexibility and ability to adopt the approach appropriate to them and their businesses within the framework set by the Code and other guidance. Each business is different and one of the key strengths of the corporate governance codes is the way they have encouraged positive change, not least through applying peer pressure, as opposed to prescribing a 'one size fits all' approach. This has worked much more effectively than imposing a rigid regulatory regime, which does not allow for the very real differences in the ways companies operate.

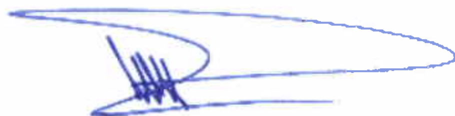
There have also been a number of individual contributions to the debate over recent weeks (eg Paul Myners, Richard Greenbury) and some of these have focused around the role of non-executive directors, the support they should receive and the time allocation they should give to their roles.

As a general point, we believe it is not helpful to blur and polarize the roles and responsibilities of the unitary board, nor should we be looking to dissuade good candidates from putting themselves forward to non-executive director appointments.

In our view, it is important to recognize that inherently unmanageable complexity (as in the case of the banks, for example) arises principally as a result of executive over-stretch. If a non-executive director is not able to broadly understand the business of a group in a sector they are familiar with, in say 25 to 35 days per annum, then it is likely that the executive team are not really in a position to manage it.

It is essential, in our view, that a measured response is made to the Code review and that the failings in one sector are not allowed to impact adversely on the considerable achievements which have been made in establishing a positive corporate governance climate over recent years.

Yours sincerely



Mark D Peters
Head of Secretariat