



TESCO PLC

TESCO HOUSE, DELAMARE ROAD, CHESHUNT, HERTS. EN8 9SL
Telephone: 01992 632222 Ext.

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

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Dear Mr Hodge

Review of the Effectiveness of the Combined Code: Progress Report and Second Consultation

Tesco welcomes the opportunity to respond to FRC's second consultation reviewing the effectiveness of the Combined Code. We submitted a response to the initial consultation in June this year and would repeat the view we expressed in that response that the existing Code and the "comply or explain" approach work well and provide an appropriate framework for corporate governance.

We therefore welcome the FRC's conclusion in its progress report that there is no need for major change to the Code and that a flexible approach remains the most appropriate way of raising standards of corporate governance in listed companies.

We also believe that the recommendations made by Sir David Walker for banks and other financial institutions reflect the specific systemic risks which relate to institutions in that sector and are not appropriate or necessary for all listed companies. We feel that any changes which the Walker Review recommends be made to the governance of those institutions ought to be dealt with outside the Combined Code by that sector's regulator, rather than by incorporating them as guidance and provisions in the Combined Code.

We believe in particular that the Walker recommendations on risk committees are not appropriate for application to all listed companies, which are already required to apply robust and thorough risk management processes in the running of their businesses. We also do not support the wider application beyond the financial sector of the Walker recommendations on remuneration,

Directors:
D.E. Reid, C2A (Chairman), Sir Terry Leahy (Chief Executive), R.F. Chase CBE (Deputy Chairman),
C.L. Allen CBE, R.W.P. Brasher, P.J. Cusack, P.A. Clarke, K.R. Cook, H. Einsmann, E.G. Hanna, A.T. Higginson,
K.J. Hydon, T.J.R. Mason, L. McIlwee, L.J. Neville-Rolfe CMD, D.T. Potts, J.A. Tammenoms Bakker.

J.M. Lloyd (Company Secretary)

Registered in England and Wales No: 445790. Registered office: Tesco House, Delamare Road, Cheshunt, Herts. EN8 9SL.
VAT Registration Number: GB 229 4302 31

since the existing statutory Remuneration Regulations are already very prescriptive in terms of disclosure requirements.

We share the FRC's view that the continuing credibility of the "comply or explain" approach depends on open and transparent disclosure of governance matters and on investors interpreting those disclosures in an enlightened and objective way.

We support the adoption of the three guiding principles by the FRC when assessing the case for changes to the Code and its accompanying guidance. We agree that it is important to avoid an increase in the overall level of prescription in the Code and to preserve its principles based style, and we believe that any changes made should have the clear aim of enhancing disclosure on the issues of most importance for shareholders and reducing boiler-plate and box-ticking.

We have set out below responses to the specific issues you have raised for further consideration:

The responsibilities of the chairman and the non-executive directors

Would it be helpful to further clarify the role, key responsibilities and expected behaviours of the chairman, SID and the NEDs?

We believe that the current legal framework and best practice governance requirements provide an appropriate framework for determining the role, responsibilities and expected behaviours of the chairman and NEDs in governing the company. To the extent that the FRC decides that further guidance is needed it should take the form of a high level "best practice" recommendation on a non-binding basis.

Should further guidance be provided on the time commitment expected of the chairman, SID and the NEDs?

We support the continuation of the existing approach in the Code of simply requiring a NED's letter of appointment to include an indication of the time commitment expected. This approach allows each company to tailor its requirements on time commitments to the needs of that business. We do not think that it is appropriate to introduce into the Code a specific rule for how much time commitment should be expected from the chairman and NEDs. NEDs are already required to disclose to the Board their other significant commitments and the chairman takes responsibility for ensuring that sufficient time is being spent by NEDs on board activities. He would take appropriate action if he concluded that a director's other commitments were inconsistent with those required by the company. Setting a fixed time commitment could also discourage potential NED candidates, particularly those who are full-time executives in other companies.

Board balance and composition

Does the Code give sufficient emphasis to the need for relevant experience among the NEDs collectively?

The Code already requires there to be an appropriate level of relevant experience amongst the NEDs. The board itself is in the best position to decide what skills are needed in order to ensure that NEDs provide the right level of contribution to the efficient governance of the business, and should look at the wider skills and experience base of their members when undertaking succession planning. We do not think that shareholders or other external stakeholders should put pressure on boards to recruit NEDs with specific experience, and additional guidance in the Code may encourage the exertion of such pressure.

Have the independence criteria, and in particular the "nine year rule", resulted in a loss of continuity and valuable experience?

As we outlined in our previous response in June, we believe that as long as a director continues to provide the right level of contribution and challenge in the board, with continued evidence of the exercise of independent judgement, it should not be necessary to require him to stand down simply because he has served a particular number of years. We would emphasise that there is not currently a "nine year rule" in the Code or elsewhere: the length of tenure of a director is as you know just one of a number of factors which the Code recommends be taken into account in assessing independence. The fact that it is now regarded by some as being a specific rule is, in our view, an example of the dangers of moving away from a principles-based to a more prescriptive approach, and the increased focus on box-ticking which it can encourage. We feel there should therefore be a more pragmatic and flexible approach by shareholders and companies in judging whether a NED is independent, and we would welcome the FRC's support in discouraging the box ticking mentality which voting agencies and shareholder representative bodies sometimes apply in interpreting the independence principle.

Has the recommendation that boards comprise at least 50% independent NEDs resulted in boards becoming bigger?

We feel that the requirement for at least half the board, excluding the chairman, to comprise non-executive independent directors, can lead to over-large boards. Although well intended this can have perverse effects. For example, there are costs in terms of fees and board and executive time, and decision making can become more difficult. In addition, the larger the board, the more the logistical challenges.

Frequency of director re-election

Would changes to voting increase accountability to shareholders?

We do not believe that annual re-election for all directors is preferable to a three year rotation. Nor do we support the annual re-election for the chairman

of the board and committee chairmen, as this would result in inappropriate focus on individual directors rather than the board as a whole.

We feel that introducing a binding or advisory vote on specific issues, or the corporate governance statement, would lead to increased boiler plate disclosure, as companies would be likely to apply a "box ticking" approach to ensure compliance, which in turn would reduce the value of such disclosure to shareholders.

Board information, development and support

Should there be more guidance on the information and development needs of NEDs and the support mechanisms to be provided to boards?

The Code already stresses the importance of a full induction, learning and development programme for directors, and expects the chairman to take responsibility for these areas. Board effectiveness reviews should already gauge NED feedback on how effectively such training is being provided.

In addition, in order to carry out their role effectively, NEDs should of course be adequately resourced. The Code already provides that all directors should have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities, and they should also have access to the advice and services of the company secretary. We believe that these are both important aspects of maintaining good corporate governance and that the Code thereby ensures that non-executives are given strong support in carrying out their work. While we feel that it is appropriate for the nature and sources of that support to be kept under review, we do not feel that it would be necessary to adopt additional structures within the governance framework to provide support for non-executive directors.

Board evaluation

Should the Code be amended to recommend an externally facilitated board evaluation at least every two to three years?

We believe that a regular thorough review of the effectiveness of the board and its committees is important. Periodic externally facilitated reviews can also play a valuable role, although the timing and cost of an external review may be significant issues for some companies. The most appropriate approach to an effectiveness review will, however, often depend on the circumstances of the company at the relevant time and companies should be able to retain their ability to choose when to use external facilitation.

We also feel that whether an effectiveness review has been conducted on an internal or external basis is less important than providing comfort to shareholders that an appropriate process has been followed.

Risk management and internal control

Should the board's responsibility for strategic risks and setting risk appetite be made more explicit? Is there a need for all or parts of the Turnbull Guidance to be reviewed? To what extent are the Walker Review recommendations for banks and financial institutions also appropriate for other listed companies?

As we mentioned in our previous response, we believe that it is important to ensure that bad management decisions within the financial sector do not undermine the value of the existing Code or lead to the conclusion that there must be something wrong with the rest of corporate Britain. Different businesses face different risk profiles, and companies are already required to apply robust and thorough risk management processes in the running of their business.

Requiring companies outside the financial services sector to apply new approaches which Walker has recommended for banks and other financial institutions may well not be appropriate, and making companies create a separate risk committee or appoint a Chief Risk Officer could hinder companies' ability to structure their risk management approach according to their business model and the environment in which they operate. We believe that the current 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 the management of risk and internal controls, works well.

We believe that the current Turnbull guidance works well and does not need to be amended. Indeed, making further changes could result in more boiler plate disclosure on risk.

Remuneration

Should the Code be revised to ensure consistency with the European Commission's recommendations on remuneration and the FSA's proposed code of practice for financial institutions?

We agree with the overarching principle that remuneration policies should be consistent with effective risk management. We would question, however, the benefit of incorporating the European Commission's "Recommendations on Executive Pay" into the Code. We believe that much of the substance of the Recommendations is already covered within UK remuneration best practice, and increasing the amount of guidance and regulation may make reporting on remuneration more complex.

Should shareholders be given a more direct role in setting remuneration (and if so, how)?

We feel that there is already an appropriate level of shareholder involvement in remuneration issues, and this has worked well historically. Shareholders have delegated to the board the ability to determine the remuneration policy for a company and the level of reward for individual directors within that

policy. To the extent that long-term remuneration plans are adopted or amended, they are subject to shareholder approval. Shareholders also have the right to register any concerns they may have with the board's approach to remuneration matters through their voting on the remuneration report. We would question the benefit of allowing a vote on each individual director's remuneration package rather than the single vote on the directors' remuneration report. It would make the resolutions and voting process at the AGM more complex.

Quality of disclosure by companies

Should the disclosure requirements in the Code be rationalised? Should the FRC or FSA monitor or enforce "comply or explain" statements?

Given that companies devote substantial time and resources to complying with the current requirements for narrative reporting, it is clearly important for reporting to be useful to its intended audience. We would welcome a review of the current requirements (including, for instance, the table of attendance at meetings) which had the aim of ensuring that the disclosure which companies are required to make is made as streamlined and appropriate to the needs of shareholders as possible.

We do not think that the FRC or FSA should monitor or enforce "comply or explain" statements. If they were to carry out an enforcement role, the current constructive level of engagement by shareholders with companies themselves might well be undermined as shareholders relied instead on the feedback from the FRC/FSA.

The great strength of "comply or explain" is that it allows companies to provide an explanation, if appropriate, as to why they have not applied the Code, and investors can then judge whether this is acceptable, having engaged with companies to understand the company's reasons. We would furthermore support the principle of "apply or explain" rather than "comply or explain", since it would make it clearer that there would not be non-compliance if a company did not apply the Code in certain areas, but provided an explanation of why it had not done so.

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**