

From: Martin Finnegan [m.finnegan@nabarro.com]
Sent: 05 October 2009 16:44
To: Chris Hodge
Subject: Review of The Effectiveness of the Combined Code

Dear Sirs

I read with interest the Progress Report and Second Consultation as published in July 2009 and flag below comments on 2 specific points:

Board Balance and Composition:

How to get the balance between the need for independence and the need for experience

Many companies would benefit from the appointment to the Board of an independent "adviser" director and I believe the guidance should encourage a Board to at least consider whether this is appropriate.

The last 10 years has seen a raft of legislation, in particular, with respect to financial services which has added significant complexity to the considerations that come into play when assessing director duties in the context of the decisions a board of directors must take on a day-to-day basis. The recent turmoil in markets supports the fact that directors are increasingly presented with challenges that few of their predecessors faced. .

Whilst the typical plc board structure and corporate governance regime are perceived to be relatively robust, recent events must lead one to question whether these are in fact sufficient to protect investors, creditors and not least directors themselves. There is an argument (particularly for larger public companies) that a board would benefit from the appointment of an independent "adviser" director on a permanent basis. I am not proposing that existing advisers e.g. retained company accountants or other advisers, undertake this role as there exists the possibility for compromise, i.e. any non-executive who is also part of any advisory firm which makes substantial fees from the company cannot be perceived to be truly independent.

The selection of an appropriate independent adviser can be tailored to the needs of any given company, so a resources company is likely to benefit more from the appointment of an appropriately qualified "competent person" as opposed to an accountant. Furthermore, companies are likely to appoint independent advisers who have largely "seen it all before" and can therefore add real value, just as many existing non-executive directors do. I believe that this is a logical development of the type of non-executive director that companies should be appointing

The way this would work is that on key decisions where for example there was a fundamental question of financial interpretation, assessment of reserves, law, or other highly technical matter at stake, when the Board and/or its retained advisers were split as to how best to proceed, then the retained advisers and/or Board could look for the relevant independent adviser director to take the lead on how the matter is resolved. For example, they could insist on a second opinion being obtained, or at the very least provide a very sensible back-up in the sense of being an independent sounding board, or indeed brake where it seemed that matters were being dealt with too hastily.

Such appointments would need to be implemented on a case by case basis as no one would wish to slow down the operation of a board, but if implemented sensibly there is no reason that it should. No one is suggesting that an independent specialist be they accountant, resources expert, lawyer, or other adviser director should be involved in day-to-day decision making, that would be inappropriate just as other non-executive directors are not involved in such decisions. Where, however, this could be used to good effect is on those matters that clearly the Board is troubled by and a process involving running this through a separate board committee headed by the adviser director may represent a sensible check and balance, and if nothing else may limit the potential liability of both the company and individual directors.

Board Information, Development and Support

I believe increased guidance needs to be given on when it may be appropriate for NEDs to take independent advice. Many difficult situations arise in the running of a company without the need for NEDs to take independent advice. Typically it is not the situation itself which dictates the need to take independent advice, but how it is being handled. Consequently, there is no definitive list that can be referred to or appended to a NED's appointment letter representing situations when this need may arise, but I believe further guidance (with illustrative examples) would be of real benefit. To the extent it may assist it seems to me that a NED that finds himself in any of the following categories is likely to be justified in seeking independent advice:

- his ability to exercise independent judgment is being continually hampered by the conduct of the Board;
- he has very real concerns that the Company's cash flow and general financial position is so weak it may lead to insolvency and the situation is being ignored or seriously mismanaged by the executive directors;
- he is in fundamental disagreement with existing or proposed remuneration policies; or
- more generally he is in a situation where he considers corporate governance best practice demands it.

I suspect most NEDs would see taking independent advice as the beginning of the end of their relationship with the Board. I don't see why this need be the case for a robust Board. Taking independent advice could in fact be a catalyst for change at Board level resulting in the Board taking better and more balanced decisions in the longer terms interests of more stakeholders.

Conversely, NEDs should not be looking to run for the cover of independent advice out of an abundance of caution type approach, which is only likely to slow down the workings of the Board if NEDs seek independent advice too frequently and unnecessarily, and this is why I believe more guidance would be very helpful in striking the right balance.

Arguably too few NEDs have taken advantage of their ability to seek independent advice which if used appropriately may be of considerable benefit to the Company, its shareholders and creditors. Hindsight is a wonderful thing, but it is quite clear that many companies that have suffered during the financial crisis where presided over by a dysfunctional Board, including NEDs paralysed by fear from challenging the Machiavellian like behaviour of their senior executives.

I doo hope this contribution is of some interest.

Yours faithfully

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