

SPORTS DIRECT

International plc

Unit A, Brook Park East, Shirebrook, NG20 8RY
Tel: 0845 129 9200 Fax: 0845 129 9201 VAT: GB 898 4397 43

28 February 2018

BY EMAIL: codereview@frc.org.uk

Catherine Horton
Financial Reporting Council
8th Floor Aldwych House
125 London Wall
London
EC2Y 5AS

Dear Ms Horton

Proposed Revisions to the UK Corporate Governance Code and Guidance on Board Effectiveness

We write in response to your consultation on proposed revisions to the UK Corporate Governance Code (**Code**) and Guidance on Board Effectiveness (**Guidance**).

Sports Direct supports many of the proposed reforms, most of which appear to respond to the growing scrutiny of companies and their actions by their stakeholders. In particular we support the preservation of the unitary board concept and the “comply or explain” approach to the application of the Code. In our experience, however, there has been a hardening in the approaches of some shareholders and in particular their proxy advisors, which means that we increasingly find such parties trying to hold the business to account for alleged “breaches” of the Code, as if it were a mandatory and prescriptive set of rules. There is often very little proper engagement or consideration given to explanations provided for “non-compliance” with provisions of the Code.

We are therefore concerned that some of the proposed changes are too prescriptive. It might be helpful if, for example, the Guidance was not drafted as a series of suggestions but was instead drafted as a series of questions designed to help boards when establishing and reporting on their governance structures and practices.

Set out below are our comments on the proposed revisions to the Code and Guidance that we feel most strongly about.

1. The independence of the Chair (Provision 11)

1.1 We do not support this proposed revision, which would require the chair to be independent other than on appointment. The chair occupies a unique position on the board, and as recognised in your guidance, has a primary role in developing “*mutual respect and open communication*” between the non-executive directors and the executive team. Carrying out the chair’s role most effectively requires a deep understanding of the workings of the entire business and the establishment of close working relationships with people from many parts of the company, and in particular the executive team. This necessarily requires a significant time commitment from the chair, over and above that of a non-executive director. It is possible that any requirement that a chair should remain “independent” while occupying the role may restrict the chair’s ability to fulfil all aspects of the chair’s role fully. It was for exactly these reasons that the Higgs Report concluded back in 2003 that “*Applying a test of independence at this stage is neither appropriate nor necessary*” and that the Code has therefore to date only required the chair’s independence to be tested on appointment.

1.2 The application of the Provision 15 principles to the chair would also severely restrict an independent non-executive director’s ability to transition to the chair’s role if there was an obligation for the chair to be independent other than on appointment, given the application of the nine year rule (discussed further below). Any succession plans that involved an independent non-executive progression to the chair would be seriously compromised by this change, and would potentially diminish the valuable oversight opportunity which an experienced independent non-executive director may bring to the chair’s role.

1.3 We therefore support maintaining the current approach to the chair’s independence.

2. Determining independence (Provision 15)

2.1 Sports Direct is of the view that the board is best placed to determine whether a non-executive director displays qualities of independence, giving appropriate consideration to the provisions of Provision 15. The proposed reform would go further to transforming the Code’s provisions into a set of hard and fast rules which many shareholders and their advisors would apply strictly. Even under the current approach to independence, we have experienced significant votes against the re-election of a non-executive director whom our board considered, for reasons detailed in our 2017 Annual Report, to continue to display independence despite his position on the board for more than nine years from the date of his first election. We question the extent to which any shareholders or proxy advisors would accept an explanation as to the reasons why a non-executive director should be considered independent where the board has not first made that assessment in light of the Provision 15 factors – these factors would simply be applied as a set of rules rather than guiding principles.

2.2 We are also concerned that given that companies can, for the reasons mentioned above, feel forced to comply with the Code, the proposed changes in this area have a number of unintended consequences. For example, if there is a change in CEO when a chair has been in place for nine years, that chair would have to go even though it would be in the interests of the company for him or her to stay for at least the transition if not longer. In addition, where a non-executive director candidate had any form of pension at an appointee company, he or she could not be treated as being independent. This would be the case even if the amount of the relevant pension was immaterial to that individual and, substantively, he or she was viewed as being completely independent.

2.2 We respectfully suggest that the current approach be retained if the Code is to remain a set of principles to be applied or explained, rather than a rigid set of rules where any non-conformity is deemed to be (and treated by shareholders accordingly as) a “breach”.

3. Remuneration Committee (Provisions 32 and 33)

3.1 Rather than the new proposed requirement for the chair of a remuneration committee to have served on a remuneration committee for at least 12 months prior to being appointed as chair, we believe a better approach (if the FRC is minded to introduce a requirement of relevant experience into the make-up of the remuneration committee) would be to adopt the approach taken in relation to the audit committee in ensuring members of the committee as a whole have relevant experience and expertise. As per Provision 24, in our view it should be open to the board to satisfy itself that at least one member of the remuneration committee has relevant remuneration experience. This could be achieved either through being a member of a remuneration committee for 12 months, or through previous executive experience in (for example) human resources. This experience would not need to be held by the chair. It would be rather perverse for a newly elected non-executive director, who had (for example) served as a Head of HR during their executive career, to be prevented from chairing a remuneration committee simply because that person had not previously served on a remuneration committee.

3.2 Non-compliance with such a prescriptive requirement would likely be treated by shareholders as a compliance “failure” or “breach”. This new proposal is another example of a specific requirement being added to the Code which runs the risk of being treated by shareholders and proxy agents as a hard and fast rule, and would not lead to any appreciable improvement in the quality of oversight provided by a remuneration committee. We would support a general requirement for the remuneration committee as a whole to have relevant experience of remuneration issues.

3.3 Of greater concern to us is paragraph 103 of the Guidance which relates to Provision 33. We agree that the remuneration committee should take into account remuneration and workforce policies applying generally throughout the company when determining the policy for director remuneration. Our concern is that the Guidance suggests that the role of the remuneration committee should be far wider, and that it should in fact “*oversee not only pay, conditions and incentives but also other policies that have an impact on the experience of the workforce and drive behaviours. This includes policies around recruitment and retention, promotion and progression, performance management, training and development, reskilling and flexible working*”.

3.4 Not only would this impose a quasi-executive function onto the remuneration committee (or another committee of the board), it would detract from one of the remuneration committee’s primary functions which is to determine director and senior management remuneration. It is important that the remuneration committee has regard to the wider workforce and their remuneration experience in doing so, but there should not be a standalone obligation to oversee such workplace policies other than in taking them into consideration as part of the setting of director and senior management remuneration.

4. Workforce views (Provision 3)

4.1 We note the comments at paragraph 33 and 34 of the consultation relating to the deliberate choice of the term “*workforce*” in the revised Code to encompass various forms of worker engagement. We agree that the board should consider the impact of its

decisions on all those paid to work for the company, however it should be made clear that this definition is intended to capture views of workers fully engaged in the business but who may not fall within the legal definition of “employee”, such as “workers”. The reference in the “workforce definition” section of the consultation paper suggests that employees of third party contractors, such as agency workers, might be included, and as this could further confuse the employment status (and rights) of such workers, further guidance would be welcome on this point to clarify the extent of the board’s obligation to its workers and employees (as opposed to the workers and employees of other companies). If the FRC feels unable to define “workforce” it would be helpful if it could give guidance on the category of worker that is excluded from it – for example, service providers and suppliers.

4.2 Where it comes to gathering the views of the workforce, we believe Provision 3 is too prescriptive in setting out three methods through which boards would “*normally*” adopt for gathering views of the workforce. Boards should be encouraged to adopt flexible and bespoke approaches which best suit the circumstances of the company, but they may be less likely to stray beyond the three suggested approaches in order to avoid another example of “non-compliance”. Since April 2017 a workforce representative elected by staff has attended all meetings of the Sports Direct board to represent to the board views and matters of importance to our people, and the board has found this feedback and two-way dialogue incredibly valuable. This arrangement would not, however, satisfy any of the three “normal” methods referred to in the revised Code, and despite our experience to date of this being an effective method for bringing the views of our workforce to the board, and one which other boards may indeed wish to follow, we may need to consider adapting our approach (or including a combination of the suggested other approaches) unless this section is drafted in a less-prescriptive way to discourage shareholders from adopting a box-ticking approach come AGM time.

4.3 For the reasons outlined above regarding the somewhat inflexible approach taken by some shareholders and proxy advisors to explanations for “non-compliance”, this provision should be redrafted to encompass the wording in paragraph 35 of the Guidance which makes it clear that the three methods mentioned in Provision 3 are not the only possible methods boards may wish to adopt to gather the “*employee voice*”. Removing the three specific methods boards may wish to use to gather workforce views would help promote proper engagement by shareholders (and their advisors) in determining whether the actual method(s) adopted by the board are effective.

5. Board function and directors’ duties (Provision A)

5.1 Section 172 of the Companies Act 2006 imposes a duty on directors to promote the success of the company for its shareholders as a whole, taking into account various factors. This legal duty may, at times, require boards to make decisions for the short term. Such a decision would not constitute a breach of s.172 *per se*, however there is no allowance made in the revised Code for decisions which, while made in accordance with the s.172 duty, may not be seen to be sufficiently long-term for some stakeholders. We think that the focus on long-termism in the Code may cause confusion regarding a director’s legal duties under s.172, and we would invite the FRC to revisit this issue to consider whether further clarification could be included to reduce any confusion or contradiction between the two competing ideas.

We hope that we have adequately highlighted for the FRC some of the difficulties we as an Issuer have faced in engaging with the proxy advisors whose reports seem to be increasingly relied upon (in whole or in part) by very many shareholders. It does feel to us as though a tick-

box approach is often taken, and that explanations for “non-compliance” are not duly considered (if at all). Although we have made real efforts in the past to engage with the proxy advisors on such issues, we have no confidence that these organisation have the time, resources or inclination to properly consider whether an area of “non-compliance” can ever be adequately “explained” such that they would recommend support. Certainly, our explanations for previous “non-compliance” with aspects of the Code have not been accepted, and so in our view any steps to include yet further prescriptive requirements (“Provisions” in the Code), rather than encouraging all participants to properly consider the guidance Principles, risks further weakening the “comply or explain” approach to UK corporate governance.

Yours sincerely

Dr Keith Hellowell QPM
Chairman