

COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

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16 June 1993

A Ross Goobey Esq
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Dear Mr Ross Goobey,

My attention has been drawn to a circular which you have sent out to company chairmen in which you state that our Committee "somewhat fudged" the issue of directors' contracts in our Report. I would be grateful if you would explain your grounds for making such a statement.

The Committee's task, as you know, was to make recommendations on the financial aspects of corporate governance, not to rule on individual issues which are matters between boards and their shareholders. We set out the governance framework within which we considered that directors, auditors and shareholders should work. The Committee is not in a position to judge whether a particular form of directors' contract is appropriate, when cases will vary as you acknowledge in your circular. We cannot be said to have "fudged" what we did not address.

The contract point with which we dealt was the structural anomaly, whereby the Companies Act was out of line with accepted practice. This was an issue to which your Committee drew our attention in **The Role and Duties of Directors**. It was also a matter of general principle and so fell within our remit.

Furthermore, in your Committee's Report, which you subtitled "A Statement of Best Practice", you state that "there may be circumstances where a rolling contract should be limited to a period of no more than one year." This made it clear, first that there was in your view no matter of principle involved in the use of rolling contracts and second that you would look at cases on their merits.

It would be helpful if you could explain the apparent change in your position over directors' contracts, given the input which your Committee made to our Report.

Yours sincerely

Adrian Cadbury

POSTEL



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CHIEF EXECUTIVE

Dear Sir Adrian

Thank you for your letter of 16 June. I am sorry that my expression 'somewhat fudged' seems unfair; I accept entirely that the question of contracts is one between boards and their shareholders. However, you do address the question of contracts and some boards have taken your recommendation that 'future service contracts should not exceed three years without shareholders' approval' as giving license to three-year rolling contracts. It is the distinction between fixed and rolling contracts which your report does not opine upon, and I accept that you did not address the problem.

I am somewhat mystified by your references to 'your Committee'. I have never been party to any Committee which has given evidence to your Committee. It may be that POSTEL, as a member of the NAPF, was party to a submission, but I cannot speak for my predecessors. The issue has become an urgent problem and we believe that waiting for the investors' representative bodies to agree to a line on this matter will take too long and may be impossible - there are too many potential conflicts of interest.

There is one other item on which your Report has elicited requests for clarification. You recommend that non-executives serve a fixed term, but do not indicate what you see as reasonable. As a non-executive director of the Cheltenham & Gloucester I know that our Chairman, John Bays, asked you for guidance on this matter and you indicated that two or, at the most, three three-year appointments (with no assumption of renewal) were appropriate. Is that guidance on which you are happy to be quoted?

I would be delighted to discuss these matters at greater length with you if you see fit, and hope that my somewhat infelicitous encapsulation of the problem will not adversely affect our future relations.

Yours sincerely

Alan Fairman Godby

Service Contracts

As a matter of law and Stock Exchange requirements, copies of all directors' service contracts with an unexpired term of 12 months or more must be made available in an accessible place for inspection by shareholders. Service contracts may not be entered into for a period in excess of five years without the consent of the company in general meeting. The unexpired period of any service contract must be disclosed where a director is being proposed for re-election.

It is suggested that, as a matter of good practice, these further provisions should be observed:-

- (a) All service contracts should be approved by a Compensation Committee.
- (b) Despite the legislative provisions, contracts should not run for a period of more than three years and there may be circumstances where a rolling contract should be limited to a period of no more than one year.
- (c) Service contracts should not permit the executive directors to engage in, or have an interest in, any business similar to that carried on by any group company except with approval of the Board (though the ability to hold shares in listed companies carrying on such business is accepted).

Emoluments

The disclosure required in the Annual Report of directors' emoluments and of any compensation payments in respect of loss of office made to directors is considered by institutional shareholders to be an important feature of company legislation.

The Companies Act and The International Stock Exchange impose certain requirements governing such payments including the issue of shares and grant of loans, guarantees etc.

It is suggested that, as a matter of good practice, these further provisions should be observed:-

- (a) A Compensation Committee should be appointed by the Board, consisting solely or mainly of non-executive directors (and in the latter case chaired by a non-executive director). The Committee's function is to determine the salaries and emoluments packages of the executive directors. This would include salaries and also participation in share options, profit sharing and incentive remuneration schemes and all other bonuses and benefits receivable by the executive directors. Executive directors should not play any part in deciding their own compensation packages. The composition of the Compensation Committee should be disclosed in the Annual Report.
- (b) Those companies which do not have a sufficient body of non-executive directors to form a Compensation Committee should take steps to remedy the situation. In the interim their Annual Report should state the method by which all directors' compensation is determined.

As a consequence I am writing to let you know that POSTEL will be minded to vote against the reappointment of any Director who is on a rolling contract of more than twelve months. I have been given to understand that several other large investment institutions will support this initiative. While this policy will be a general rule we will be prepared to listen to arguments about why we should not apply it in specific cases. If any of your directors are on such contracts this clearly puts you in a difficult position, but I believe that most executives would be prepared to substitute a three year fixed but potentially renewable contract for their rolling contracts.

I am writing to the Chairmen of all the Financial Times top 100 companies to inform them of this intended action, whether or not their executive Directors are on such contracts. As I have outlined above, we do not see our role as shareholders merely being policemen, but it is up to representatives of the Owners to change a situation which is becoming a burden on companies and a matter of more general public concern.

Yours sincerely

Alastair Ross Coobey

ALASTAIR ROSS COOBEY

*I hope the reference to your
Committee is not too harsh.*

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