

Response to Higgs Review Consultation Document

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Introductory Comments

1. We welcome this opportunity to respond to the Consultation Paper for the Review of the role and effectiveness of non-executive directors. This submission is made on behalf of the Company Secretary of BP p.l.c.. It draws upon and reflects the company's governance systems but is not formally submitted on behalf of the Board.
2. The timing of this review, launched as it was in the wake of corporate failures on both sides of the Atlantic, begs an essential question as to whether current systems of governance and in particular the role played by non-executive directors are sufficiently robust to protect companies and investors in them from the perils of abuse and financial disaster. However, since the announcement of the review, the global corporate governance landscape has changed dramatically with the introduction in the United States of America of the Sarbanes-Oxley Act and consequent SEC and NYSE reforms. Those reforms, driven by legislation, appear to demand compliance with a series of standards by all companies with a US listing, including non-US companies. The composition of Board Committees and the role of, in particular, the Audit Committee of each company with a US listing is now, effectively settled for those who seek access to the world's largest capital market. Even were HM Government to secure block exemption for UK companies from the Sarbanes-Oxley Act, a moral and financial imperative all but demands compliance by UK listed companies, lest they lose out in the increasingly global competition for capital.
3. Having acknowledged the international dimension within which all governance initiatives must be considered, it is important to recall that the focus of this review must be seen within the context of domestic UK law. The current Companies Act is predicated upon a unitary board structure, within which no distinction is made between those directors who hold an executive role and those who serve in a non-executive capacity. While the prospect of a new Companies Act and European developments, particularly the European Company Statute, may in future allow for variations in this fundamental unitary board structure, for the present, and for the purpose of this review, it is understood that the role of the non-executive is to be considered within the current UK unitary board framework.
4. Within this context we comment below on those areas indicated in the Consultation Paper. For ease of reference in collating responses, we address the issues identified for comment seriatim.

Section A: Role – What role should non-executive directors perform, and how does this compare with the present position?

The Role of the Board (Qu. 1)

5. The role of non-executive directors can only be understood in the context of the role of the Board. The Board of Directors acts collectively and is comprised of individual directors who each owe a duty to the company to act in the interests of the shareholders as a whole. In this context, defining the role of the Board and therefore that of its non-executive members has traditionally been rather elusive. Broad definitions such as that adopted in the OECD Report on Corporate Governance (April 1998) shed some light on the issue: “The board of directors - or in some nations, the board of auditors - is uniquely positioned as the internal corporate mechanism for holding management accountable to stockholders” (Chapter 1 Section 27). Understanding the role that the Board and the non-executive directors are to fulfil is essential.
6. In the current UK legal framework the Board acts as the delegate of shareholders. The role the Board is to fulfil is determined by the contract between shareholders set out in the Memorandum and Articles of Association. Within the constraints of law and regulation (such as the Listing Rules, etc.), shareholders are free to decide what the Board is to do on their behalf. This decision by shareholders may be as varied as the size and activities of the companies they own.
7. Within the limits of the delegation from the shareholders, the Board must then determine which things it will do itself and which it will delegate to others. A number of factors will inform that decision of the Board. The Board is a collective body and therefore it must generally act by consensus; furthermore a Board’s decision-making process will of necessity be a formal one. As a result of such formality, the time available to the Board for decision-making tends to be limited. This requires the Board to concentrate on those things that it alone can do, or which it has by prior decision determined should be its preserve. The Board should therefore seek the most efficient manner to fulfil its delegation from shareholders and avoid matters of an extraneous nature.
8. Against this background, it is clear that the role and form of Board processes will be myriad – for instance a small, hi-technology company with a small board and shareholder base may well find it appropriate to meet frequently and retain many decision-making powers to ensure that it may consider and adapt its business model in an entrepreneurial manner. A global business such as our own, with a Board of a dozen or more directors from around the world, the majority of whom are non-executive, may well opt for a broader delegation of responsibilities and more structured meeting timetable, with appropriate meeting processes.
9. What is essential is that the Board must define what it will do itself, setting appropriate boundaries to its role and make a clear delegation of those things that

- are outside those boundaries. In our view delegations from the Board should be made to a single person – most usefully the CEO, since it is most efficient to hold a single person accountable for the exercise of delegated powers. In respect of those matters it has delegated, the Board retains a key role to monitor the output of the delegated powers against the broad goals established and to ensure that any limits it has imposed on the exercise of those powers or other directions are observed.
10. In practice, the CEO and any other executive directors, who in the course of their executive functions report to the CEO, are precluded by their inherent conflict of interest from participating in this monitoring role. This “conflicting-out” of executive directors from aspects of the Board’s monitoring role is akin to their now widely accepted exclusion from participating in the setting of their own remuneration. The task of monitoring the exercise of delegated powers therefore devolves as a matter of course to the non-executive directors. This monitoring role must be penetrating and the non-executives must devise a process for assuring themselves that the CEO is achieving what they expect in making their delegation to him. If they determine that the CEO is failing in this, it is incumbent upon them to take remedial action through dialogue and discussion and *in extremis* ultimately to replace the CEO.
 11. As regards those matters the Board does not delegate but reserves to itself, the only persons that can monitor the Board’s actions are the shareholders. For these purposes, the role of the Board is to take decisions by the collective exercise of business judgement. It is proper that each Board member, non-executive or executive, is accountable to the shareholders in this role. Each should therefore be conscious to the greatest extent possible of shareholder expectations and preferences.
 12. Within BP p.l.c. the role of the Board is defined and circumscribed in a broad set of policy statements known as the Board Governance Policies, first adopted in 1997. A copy of these Policies is enclosed for the confidential reference of the Review. These policies specify the role of the Board in the following terms:

“The role of the Board is to focus on those tasks which are unique to it as the representative of shareholders and necessary for the effective promotion of their interests”.
 13. Giving effect to such a broad role in practice, the company has drawn upon the writings of Dr John Carver, a US expert in governance issues in public sector organisations, to develop its own Governance Policies. We would commend Dr Carver’s recent work *Corporate Boards That Create Value: Governing Company Performance from the Boardroom*¹ to you for consideration. Defining the role of the Board, BP has therefore been careful to distinguish the “ends” which are to be achieved by the corporation from the “means” by which they are

¹ Published August 2002, ISBN: 0-7879-6114-0.

to be achieved. In a business corporation the Board's task of defining the "ends" or "goals" to be achieved may be relatively straightforward – in BP's case these are defined simply thus:

“The purpose of BP is business and to maximise long-term shareholder value by selling goods and services. The Group will allocate its resources to assets and activities in oil, natural gas, petrochemicals and energy businesses”.

14. Having defined the “ends” or “goal” of the company, the Board demands the accomplishment of these ends, and defines as necessary the “means” by which they may be achieved. The BP model delegates responsibility for achieving the ends or goal to a single point – the Group CEO – who is delegated authority for managing the resources of the Group to achieve the purpose. The Board circumscribes the available means for achieving the goals it has set to those that do not violate pre-defined standards of prudence and ethics – in the BP model these constraints on “means” are characterised as “the executive limitations”. These limitations address broad financial and policy matters. They may equally be considered as principles or standards governing the CEO's activities.
15. In a recent interview with the Financial Times, Lord Browne the BP Group CEO explained the model thus:

“The board is the agent of the shareholders and therefore they have the agency agreement. They've taken their money and they've committed to do some things. They hire me, I'm an employee number one. I am the agent of the board in this matter and I have to contract with them about how I'm going to do this. It's not my money. I mean, if I own the company, then yes indeed, I'm accountable to myself, I own the money, I'm a single proprietor and then I do exactly as I want and good luck to me. This is not that. These companies are not owned by the management. I feel very strongly about this indeed. Very strongly. What management has to do is come up with the ideas and the aspirations and get them accepted by the board. Sometimes it's actually very easy to have cool ideas, the toughest thing is to figure out how to do them. ... They have to have substance, they have to fit with the culture of the company, you have to have 107,000 people absolutely committed to doing this ... It's not true to say that BP doesn't have collective leadership, of course it does.... We know where the accountabilities are, but that's a very different matter. You have to have accountabilities, but equally people have to participate in the generation of the future. Equally you cannot delegate authority without limitations to that authority. This is a recipe for disaster. You always delegate two things - the action and the limitations on the action”.

16. With regard to those matters delegated to the CEO, the Board's task is then to monitor the achievement of the “goal” by the CEO in the deployment of the

resources of the Group and his observance in doing so of the “executive limitations”. In this manner the Board of BP seeks to focus on those tasks that are unique to it as the representative of shareholders and are necessary for the effective promotion of their interests. The Board remains accountable to the shareholders for the achievement of this purpose.

17. With such a model, the role of the Board, the Chairman, and the non-executive directors are influenced accordingly.

Proposal 1 - Role of the Board: *Boards could be required to make an annual statement describing and disclosing its role in the governance of the company. The statement should describe those functions that the Board will perform itself and those it will delegate. The Board should also disclose the purposes or goals it has specified could be achieved by the company. The statement could also touch on the risks to achieving those goals, together with the means to be adopted for managing those risks. In its statement of delegations, the Board could set forth the principles to be observed by its delegates, which serve as benchmarks for the monitoring role of the Board and its Audit and other committees. Executive performance can likewise be monitored against the purpose or goals established and remuneration of executive management can be made commensurate with the assessment of that performance.*

The role of the Chairman (Qu. 1)

18. The role of the Chairman will inevitably depend upon the role of the Board determined by the delegation from the shareholders and within that delegation as determined by the Board. Given that the boundaries of each of these delegations is moveable – shareholders may reserve to themselves significant powers or delegate these to the Board and the Board in turn may largely do likewise - the role of the Chairman of the Board will depend on those delegations.
19. BP has a non-executive chairman. His role is defined in Item 5 of the BP Board Governance Process, which may be summarised as follows. The Chairman is responsible for representing the Board to the shareholders. The Chairman is responsible for ensuring the integrity and effectiveness of the Board governance process. The Board as a whole has delegated to the Chairman authority on matters of Governance Process and Board-Executive Linkage. In particular, the Chairman has responsibility for engaging in systematic contact with the shareholders and for monitoring the performance of the CEO. The Chairman is empowered to make any decision, establish any policy, take any action or enter into any obligation within Board policies on Governance Process and Board-Executive Linkage and will report to the Board at its next meeting on any material or sensitive exercise of this authority. The Chairman acts as facilitator for meetings to ensure that full discussion takes place and that the variety of opinion among Board members is drawn out. He ensures that the outcome of any discussions results in logical and coherent policy pronouncements to guide the CEO and against which the performance of the Group can be monitored.

20. The BP Chairman is therefore a leader in the classic *primus inter pares* model. On those matters that the Board has reserved to itself, the Chairman must ensure that all directors are able and have the opportunity to contribute to the decision-making process. To that end, it is incumbent upon the Chairman to ensure that all directors have the requisite information available for that purpose. In those matters that the Board has chosen to delegate to the CEO, the CEO and other executive directors are subject to a conflict of interest and would ordinarily be precluded from the Board's performance monitoring role. While all directors may contribute their views in discussion, monitoring and decision-making on whether the Board's delegation has been fulfilled will be the preserve of the non-executive directors. It follows that the roles of Chairman and CEO should not be undertaken by the same person.
21. In BP and elsewhere, the Chairman provides continuity on behalf of the Board as a whole between board meetings. The Chairman is also expected to take the lead in seeking out shareholder views and in representing the actions of the Board as a whole and its non-executive members to shareholders. This of course includes in many instances acting as a representative of the various committees of the Board², which are each comprised exclusively of non-executive directors.
22. The time commitment necessary to fulfil the role of Chairman will vary from company to company and from month to month according to the exigencies of the company's business. At BP the role has traditionally been undertaken on a part-time basis, but aided by a full time professional support function (see explanation of the BP Company Secretary's Office in Sections D and E below).
23. Since BP has had a non-executive Chairman in post for a number of years the necessity for a distinct role of a "senior independent" non-executive director has been the subject of debate with shareholders. Currently the Deputy Chairman fulfils this role. While limited use has been made of the senior independent role, a number of investors have expressed support for the company's nomination of a director to this post which they feel would provide a ready conduit for communication should they be dissatisfied with the performance of the non-executive Chairman (**Qu. 7**).

The role of Non-executive Directors (Qu. 1)

24. UK Company Law currently makes no distinction between the role of executive directors and non-executive directors. The proposed statutory statement of directors' duties, while endorsing subjective elements, again makes no distinction in their role. However, clear distinctions emerge when Boards adopt the boundary-setting and delegation model, since this creates in a practical way the tasks of the non-executives. Corporate governance developments of the past

² BP has the following Board Committees: the Audit Committee, Ethics and Environment Assurance Committee, Remuneration Committee and Nomination Committee.

- decade have relied upon non-executive directors, often in Board Committees, to act as a “check and balance” without the discipline and clarity that comes from making explicit the terms of the delegation to the CEO/Executive Directors.
25. With regard to **independence (Qu. 4)**, BP endorses the view of the current Combined Code that non-executive directors should be “free from any business or other relationship with executive management of the Group which could materially interfere with the exercise of their independent judgement”. This freedom to exercise independent judgement will primarily depend upon subjective factors such as an individual’s character and integrity.
 26. A growing body of opinion questions the independent nature of certain directors after a period of board service in excess of 10 years and this is reflected in BP’s own policy expectations. However, any mandatory or best-practice limits on length of service of non-executive directors are unlikely to be practicable at a time when recruitment is already difficult due to a shortage of qualified candidates (see Section B below). While new members may bring fresh perspective to the outlook of the board, an element of continuity is also essential. It is submitted that length of service alone does not preclude the exercise of independent judgement. Other matters such as business or other relationships should be considered on a case-by-case basis. However, it is acknowledged that the appearance of independence as well as its practical exercise is also of great import to shareholders.
 27. To ensure that non-executive directors can exercise their independent judgment to fulfil their role as representatives of shareholders they require necessary information and appropriate access to professional and administrative support. These matters are explored in Sections D and E below. Non-executive directors serving on boards which have made delegations of authority should not seek to interfere without due cause in the exercise of delegated authority. The boundaries set by the Board on its actions and its decisions as regards delegations should be observed by each of its members since only those to whom the delegation has been made can be held accountable.
 28. Directors’ business judgement should not be compromised by personal financial concerns. This means that care should be taken in both setting the appropriate method and level of compensation for service as a non-executive director. Furthermore requisite comfort should be provided such that their personal assets will not ordinarily be imperilled by their service on the board (see discussion of insurance and indemnity in Section B below).
 29. The **time commitment (Qu. 6)** required of a non-executive director will naturally vary from company to company according to the role of the Board as determined by the shareholders and the Board. The demands now placed on non-executive directors of listed companies are considerable – often requiring substantial preparation time, committee work and international travel, aside from

- participation in board meetings themselves. Recognition that in a large and complex company the Board cannot involve itself in every business decision will drive the Board to delegate responsibilities and set boundaries to those matters which will remain its preserve. The time commitment needs to be managed to ensure that the Board will have sufficient time available to fulfil the role established for it.
30. It is a concern that certain directors might be tempted to “spread themselves too thinly” by serving on too great a number of boards, however, setting a **limit on the number of positions held (Qu. 6)** would appear an arbitrary exercise. For certain candidates service on more than a single board might prove too great a commitment, while others might comfortably and usefully serve on several boards concurrently. It is self-evident, that those who serve in an employed or executive capacity on one board would ordinarily have less time available for service on other boards. What is important is that on the appointment of each director the company ascertains that the candidate will be able to provide the requisite time and attention to play a full part in the work of the Board as that has been defined.
31. In Germany the “Cromme” Corporate Governance Code (Rule 5.4.2) precludes members of Management Boards from serving on more than 5 supervisory boards of non-group listed companies. However, rather than the introduce a Cromme Code-style rule here in the UK, we would favour the introduction of a practice whereby listed company boards were obliged to make a reasoned assessment of the expected time-commitment required of its members, incorporating suitable contingency for the exigencies of the business. The time demands on the individual is a matter of concern to each of the organisations with which directors may serve. On directors’ appointment or re-election, candidates should be required to confirm that they reasonably expect to be able to fulfil such a commitment. Transparency in terms not simply of the number of outside appointments but of the estimated time commitments should provide comfort to investors anxious to ensure that directors have adequate time available and should also deter any candidate who might otherwise be tempted to take on more appointments than could reasonably be managed.
32. While introduction of such a best practice requirement might provide short-term inconvenience to those companies whose directors are “collectors” of board appointments, in the medium term companies would have greater assurance that directors were able to make an appropriate contribution to the business, thereby enhancing the governance of the company. In the long-term, such a rule might also serve to encourage recruitment from broader pool of candidates by necessarily seeking to match candidates with time to contribute with boards

requiring particular contributions (see Section B below).

Proposal 2 – Time Commitments / Limit on Number of Appointments: *A best practice direction could be introduced in the Combined Code that listed company boards should periodically make a reasoned assessment of the expected time-commitment required of its members (incorporating suitable contingencies for the exigencies of the business). This estimate or the assurance that it has been made could be disclosed in the Annual Report or Directors' Remuneration Report as appropriate. On directors' appointment or re-election to the Board, candidates should be required to confirm that they reasonably expect to be able to fulfil such a commitment.*

33. With regard to the **statutory statement of directors' duties (Qu. 8)**, it is considered appropriate that there is no overt distinction between directors who hold executive appointments from those that serve in a non-executive capacity. This is in keeping with the collective responsibility that is a fundamental tenet of the UK's unitary board structure. The retention of the subjective elements in the draft Companies Bill Schedule 2, Paragraph 4 (b) foresees that executive directors may be held to a higher standard of care, skill and diligence than their non-executive counterparts.

Proposal 3 – Statutory Statement of Directors Duties: *The lack of an overt distinction between directors who hold executive appointments from those that serve in a non-executive capacity in the draft statement of directors' duties is in keeping with the collective responsibility that is a key tenet of the UK's unitary board structure. However, it is nonetheless important that the draft statement in Companies Bill Schedule 2, Paragraph 4 (b) retains subjective elements. This will ensure that executive directors may be held to a standard of care, skill and diligence commensurate with or greater than their non-executive counterparts as a consequence of their own greater knowledge.*

34. In summary, we believe that the role of non-executive director is a vital one, which when clearly defined and understood is valuable in ensuring that a company remains focussed at all times on its ultimate goal of delivering long-term value to its owners. It is suggested, however, that in many UK corporations this simple role may have become obfuscated by elaboration of process to address both internal political and external regulatory demands, particularly in the financial services arena. Clarity in definition of the role of the Board should in turn lead to the adoption of more efficient Board processes, allowing a more effective contribution from non-executive directors.
35. The role of a non-executive director at a large listed company with an international or even global business is necessarily complex and demanding. It is therefore essential that non-executive directors be supported in their role by the processes adopted for the operation of the board and also through those mechanisms outlined in the response to Sections D and E below.

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Section B: Attracting and appointing non-executives – What knowledge, skills and attributes are needed, and what can be done to attract, recruit and appoint the best people to non-executive roles?

36. The current UK legal framework provides that all directors serve at the behest of the shareholders as a whole and may be removed by them if they are considered to be failing to represent their interests. It may therefore be inappropriate for directors of listed companies to be nominated by individual shareholders or groups of shareholders, who might thereby expect their nominee to serve their sectional interests rather than those of the shareholders as a whole. The current listed company mechanism in which a nomination committee of the Board is formally constituted to make appointments on behalf of the shareholders as a whole, avoids any conflict of interests which might arise were directors to consider themselves “delegates” of particular shareholders. The submission of new appointees for election by shareholders following their appointment and for periodic re-election thereafter, maintains the integrity of the Nomination Committee system. Shareholders retain the ultimate sanction to remove directors. We see no advantage and a number of risks in changing the nomination and appointment system, which we believe as presently constituted safeguards the interests of the shareholders (**Qu. 12**).
37. As observed in the extract from the Hampel Review quoted in the introduction to the Consultation Paper “What matters in every case is that the non-executive directors should command the respect of the executives and should be able to work with them in a cohesive team to further the company’s interests”. We would concur with this view, while noting that it is somewhat ambiguous. An executive may have respect for an individual *per se* and respect for an individual *qua* director of the company. We would assert that both are desirable to ensure a cohesive team approach by the Board to further the company’s (shareholders’) interests.
38. What might command such respect is almost entirely a subjective matter and will vary from company to company and from director to director (be they executive or non-executive). Similarly the requisite **knowledge, skills and experience** (**Qu. 9**) required of individual board members will and should vary – the board as a whole should provide a range of knowledge, skills and experience to be able to provide a broad strategic perspective and to be equipped to carry out its monitoring and representational functions, as explained in Section A above. At a large global enterprise such as BP, the requisite knowledge, skills and experience that are desirable may well be of a higher and broader level than at a smaller company. This is natural both to aid the Board in achieving a truly global and strategic perspective and also to foster respect among executives who are by definition national or international leaders in their business roles.
39. While knowledge, skills and experience may vary tremendously, certain personal qualities and attributes are essential. In the role expected of non-executive

- directors integrity, sound judgement, keen analytical and critical faculties and an ability to work in a collegial context, while being sufficiently robust to express individual views, are highly desirable attributes. Some would say that these attributes are essential if non-executive directors are to fulfil their monitoring and representational functions on behalf of shareholders. Processes such as those outlined in our response to Section A (above) may aid the achievement of these functions but much will ultimately depend on the individual directors themselves.
40. While BP has hitherto been able to **recruit (Qu. 12)** and generally retain suitable persons to serve as non-executives, it is sympathetic to those, particularly in smaller companies who observe that the pool of candidates is too small. As a company, BP seeks to encourage senior employees to serve as non-executive directors on outside boards. BP considers this provides valuable training and perspective to those of its staff to the benefit of both companies.
41. If a greater number of enterprises and professional firms (lawyers, accountants, etc.) were willing or encouraged to do likewise, the pool of potential non-executive directors might readily be increased. However, the potential pool from professional services firms may be difficult to tap since these firms would most likely be precluded by reason of conflicting interests from working with listed companies on whose boards their staff served. While a code of practice and “Chinese walls” might be employed to ameliorate certain concerns, it seems likely that the potential conflicts of interest would deter many candidates from putting themselves forward as the potential fees for providing professional services to companies would generally far outweigh any compensation remitted to the firm as a result of their service in the capacity of non-executive director.
42. Since those considered qualified to serve on the board of BP or other global listed companies as non-executive directors have generally held major appointments elsewhere, appointments are often many months (if not years) in gestation and planning. Recruitment is an on-going process in most companies, but particularly so in a company of global scale with a board of a dozen or so non-executives in which the balance of non-executives must be maintained. Anything that improves the marketplace for recruitment of non-executive directors would be welcome. The active marketplace in executive search consultants or “head-hunters” has developed in recent years. There would appear to be no shortage of competition in that market. It would be worth sampling the views of participants in that market on what could be done to broaden the recruitment pool (**Qu. 13**). (e.g. we believe that among those senior managers retiring each year from BP there would be a number of candidates willing and able to give their time to serve as non-executive directors, particularly in smaller cap companies).
43. In terms of **compensation (Qu. 14)** for service as non-executive directors, UK boards lag behind their North American counterparts in quantum terms, but are generally ahead of equivalent European boards. For a number of companies this may lead to difficulty in attracting candidates from the US, which may represent a

- serious deficiency if, as in the case of BP, a sizeable proportion of the companies' business is located there. Other problems we have encountered in achieving a broad geographical recruitment spread, include the difficulty of attracting candidates from Germany where the limit on the number of board appointments a person may hold is often exhausted by local appointments.
44. With regard to forms of compensation, international practice varies a great deal. For instance in the US stock retainers, restricted stock plans and even stock option awards are quite commonplace for non executive directors. The UK legal and regulatory framework does not lend itself to any of these reward mechanisms. Reflecting this and more general concerns that stock compensation can lead to conflicts of interest, BP favours simple cash retainers for service on the Board. In line with the company's general compensation practice, this is set at a level commensurate with contribution to the business in furthering the Board Goals. The level of remuneration for service as non-executive director is reviewed periodically and is subject to an overall aggregate limit approved by the shareholders. Reflecting the size, global nature and US exposure of the company's business, levels of non-executive compensation at BP are higher than the UK FTSE 100 average.
 45. A number of investors are keen to encourage the remuneration of directors in company shares as an attempt to link the directors' personal financial interests with those of shareholders. While BP is not unsympathetic to such views, a linking of personal financial interests to those of shareholders would lead almost by definition to conflicts between them. For this reason certain jurisdictions, such as the Netherlands, specifically prohibit supervisory board members from holding company stock.
 46. BP has also been mindful of the need not to deter those candidates from academia and the realm of public service to whom stock compensation might be unattractive or even unworkable (in the absence of viable tax deferral treatment in the UK). Other legal and regulatory rules prevent or overcomplicate the operation of US-style restricted stock schemes, phantom share schemes or share retainers for non-executive directors.
 47. All directors take on personal liabilities as fiduciaries. The proposed statutory statement of directors' duties in the draft Companies Bill will not alter this fundamental principle of company law. **(Qu. 15)** While it is evident that directors serving as fiduciaries on behalf of shareholders should be personally liable for their actions, the increasing prevalence of lawsuits against board members could, in the absence of appropriate **indemnity and insurance** provision by the company, deter potential candidates and prevent serving non-executives from the uninhibited exercise of their business judgement.
 48. There has been suggestion from some quarters that directors should not benefit from indemnity and Directors' and Officers' (D&O) Insurance coverage to the

extent currently permissible under Companies Act 1985 Section 310 (as amended). We consider that the provision and maintenance of appropriate indemnity and D&O insurance is essential to encourage candidates to serve as non-executive directors particularly in those UK companies with business exposure in the US, where the existence of the Plaintiffs' Bar and the prevalence of shareholder class actions can give rise to complex litigation involving directors. Indeed given the variable capacity and volatility in the D&O insurance market, the use of appropriately structured and "ring-fenced" captive and mutual insurance systems may be necessary and these should be considered in any further review of the Section 310.

49. Directors' exercise of their judgement should not be compromised unnecessarily by perceived threat of placing their personal assets at risk. Appropriate indemnities and D&O insurance coverage are important safeguards that the company should be able to provide, while not freeing directors from their underlying fiduciary duties and their ultimate personal liabilities. At a time when there are increasing expectations of non-executive directors as guardians of shareholder interest, with commensurate exposure, it is essential that they are supported in this manner, particularly in circumstances where the non-executives' assessment of a particular situation may be at odds with those in executive positions, or where there has been an orchestrated "cover-up" – the customary "insured-versus-insured" exclusion for example can operate to prevent the non-executives seeking independent advice.

Proposal 4 – Insurance and Indemnities: *If non-executive directors are to serve as effective guardians of shareholder interest, it is essential that they be supported with appropriate indemnities and insurance, particularly in circumstances where their assessment of a particular situation may be at odds with those in executive positions. Companies Act 1985, Section 310 (as amended), which permits the purchase by a Company on behalf of its Board members of suitable directors' and officers' liability insurance coverage, should be maintained. Given the variable capacity and volatility in the D&O insurance market, the use of appropriately structured and "ring-fenced" captive and mutual insurance systems may be necessary and these should be considered in any further review of the Section 310. The Market must be encouraged to structure its products in a manner that enables non-executives to obtain appropriate assistance and, potentially, protection where there is a possibility that culpability lies with the executive directors (for instance, in cases of orchestrated cover-up).*

Section C: Structures and accountability – Do existing structures and procedures facilitate effective performance by non-executive directors?

50. In the earlier sections of this response we have explained at some length that the role of the Board may vary but needs to be clearly defined and understood. Whether each Company Board has a clear understanding of what its role should be and has communicated this to its members to aid their understanding of their own role is subject to question. We believe that once the respective roles of the Board and its constituent members are clearly understood, appropriate structures may be adopted and accountability to the shareholders for the stewardship of their company can be achieved – the ultimate purpose of corporate governance.
51. The recent adoption of many Combined Code provisions in the US under the auspices of the Sarbanes-Oxley Act, and other post-Enron and WorldCom reforms at the SEC and the NYSE, serves to demonstrate the Code's widely perceived success in addressing issues of good governance (**Qu. 16**). As a company BP has been an enthusiastic supporter and promoter of best practice standards many of which are reflected in the Combined Code. Developments in best practice of various Board Committees in the key areas of Audit, Remuneration and Nomination are to be encouraged and have generally served to enhance the role of non-executive directors and underscore their importance in the governance process. Other committees comprised of non-executive directors can be used to aid the efficiency of the Board in other areas. For instance, to monitor compliance with ethical and environmental standards set forth in BP executive limitations, BP has established an Ethics and Environment Assurance Committee.
52. Having noted developments that have enhanced the non-executive role, we are concerned that certain recent developments inadvertently run the risk of undermining the authority of non-executive directors or even the role of the Board itself. Since the Cadbury Committee, and most recently demonstrated by the provisions of Sarbanes-Oxley, the emphasis on the adoption of certain structures or processes by companies regardless of their appropriateness to the particular company is a cause for concern. Governance structures should be fit for purpose and should take account of the boundaries established by the shareholders and the Board. Insistence on certain forms regardless of circumstances can lead to a box-ticking culture in which true accountability - a fundamental of good governance - may be lost.
53. By way of example the introduction in the UK of the mandatory vote to approve rather than *receive* the Directors' Remuneration Report runs the risk of substituting the authority of the Remuneration Committee, by returning the authority to shareholders and absolving that Committee of its responsibility for setting appropriate policy and reward. It may also create confusion around decisions the Committee has taken in the exercise of its delegated powers. Non-executive directors derive their authority from shareholders and they should be accountable for the fulfilment of their delegated powers. However, measures

which take back decisions already delegated to the non-executives placing the decision-making power in the hands of those who, notwithstanding full disclosure, are always likely to be less well-informed than the Remuneration Committee, appears a retrograde step. If shareholders are dissatisfied with the judgement exercised on their behalf by the directors the proper course of action is to seek the removal of those directors. If non-executive directors are to continue to serve in the key role of representatives of shareholder interests with companies, it is important that the effect of new measures on their role and authority are considered and addressed at the outset.

54. With regard to the question of the independence of non-executive directors (Qu. 16), your attention is drawn to the discussion in Section A. In view of the proliferation of definitions in institutional investors' governance policies, a uniform definition or set of principles to be observed would appear desirable in the Combined Code. It is open to debate whether objective criteria such as the existence of cross-directorships and length of service should be included in any such definition. While the former might in some situations properly be outlawed as giving an appearance of partiality (i.e. lack of independence) we do not believe that long service *per se* leads to a lack of independence.

Proposal 5 – Combined Code “independence” definition: *It is suggested that the Combined Code definition of directors’ “independence” be reviewed. The goal should be to have a uniform definition, which avoids the current position where different institutional investors have different approaches, which sometimes appear to be at odds with criteria of ability and integrity. For a non-executive’s independence to be called into question raises reputational issues for that director. The position should be made clear. A form of annual assurance both that succession-planning and independence have been actively addressed, should be sufficient to ensure that boards maintain this in the forefront of their minds.*

55. The Board and Board Committees should themselves set the agendas for their meetings rather than allow executive management to be the sole determinant of their activities. This is particularly important when the Board is exercising its monitoring role – observing the performance of the executive management in its delegated administration of the business. To aid this process, the support of a Company Secretary function of appropriate quality and independence clearly directed to serve the Board of Directors as a whole should be considered. In practice, this function can assist in the proper functioning and orderly process of the Board and Board Committees’, and provide essential resources to assist non-executive directors in their tasks, independent of the executive management.
56. Boards should not be concerned with “approving” management decisions. In practice, however our experience of practices outside BP is that they are frequently called upon to “rubber-stamp” lesser decisions taken by management within the scope of its delegated authority from the Board. In doing so the Board absolves management of responsibility for the decision, instead taking on that

responsibility directly itself. Unless the Board believes it can take a superior decision to that taken by the management delegate, who is after all employed by the company to make such decisions, it should not do so. The Board should focus on ensuring that in exercising the delegated decision-making powers management has considered and properly applied relevant factors of strategic importance to the company and observed the limitations on its actions set by the Board. In this manner, non-executives may readily “challenge executive decisions or expose serious problems” (**Qu. 22**). We would caution that in boardrooms where executive management controls the agendas and non-executive directors are wholly dependent upon executive management for information and research capability, such challenge and exposure might be harder to achieve, even if individual directors were to have a better understanding of their role on the Board.

57. The BP Board Governance Process (outlined in Section A above and in the attached booklet) relies upon a strong function provided through the Company Secretary’s Office that serves the interests of Board alone. Senior professional staff from the Company Secretary’s Office work alongside the Chairman and committee chairmen, providing a valuable resource that may undertake further research assignments on behalf of the non-executive directors. This support structure is examined in more detail in Sections D and E below.
58. While establishing performance measures for individual non-executives may be feasible, meaningful reporting on performance against those measures may prove more elusive (**Qu. 20 and 21**). What disclosures would be appropriate to shareholders in a scenario where the non-executives had counselled against a proposal by executive management that was subsequently dropped or in which the non-executives were in agreement with the strategic direction proposed by a company CEO? It lies with the Chairman to ensure that the Board is performing appropriately. If necessary a general principle could be adopted as part of the Combined Code that the Chairman should positively assure the shareholders annually through a statement in the Annual Report and Accounts that the Board is performing effectively.

Section D: Relationships with shareholders and others – Do existing relationships with shareholders or others need to be strengthened?

59. In view of the UK's unitary board structure and the collective responsibility of the Board as a whole for matters delegated to Board Committees, we believe that the majority of contact between the non-executives and shareholders should most appropriately be directed through the Chairman and those directly representing him (**Qu. 23 & 24**). The Chairman should be responsible for drawing out full discussion at Board meetings and thus it is appropriate (particularly in cases where his role is non-executive) that he should be able to represent and speak to the views of shareholders directly. In cases in which the Chairman and CEO roles are combined, or where the Chairman is an executive position, it is perhaps appropriate that the senior independent non-executive be able to play an active role in the process of appropriate non-executive dialogue with shareholders.
60. In companies with a non-executive Chairman, that officer generally provides the most senior contact for shareholders, particularly institutional investors. This is not to be confused with the normal role of the CEO to explain the operating performance of the company to analysts at regular intervals. Investors and Chairmen should feel there is an open door between them to be used as and when necessary. If there is a problem in the eyes of shareholders, it may be best that they should have early preventative discussion with the Chairman rather than delay and leave the company exposed as a result to subsequent "selling-down" of its stock. Recent corporate history in the UK and US affords examples in which if concerns expressed had been acted upon earlier, disaster could have averted.
61. With the rise in responsibility of certain Board Committees (Remuneration Committee and Audit Committee) there may also be circumstances in which it is appropriate for the Chairmen of those committees to engage directly with shareholders and investor groups (for instance, the proposed introduction of a new executive director reward programme, etc.).
62. At BP we have found that the **Company Secretary's Office**, (**Qu.26**) is able to maintain a healthy level of dialogue with a range of institutional investors as well as concerned retail shareholders, to support and supplement the role of Chairman and non-executives. We consider that this model is advantageous to the shareholders, the Chairman, the Board members as a whole and the wider company, in being a ready and accessible facility for contact and consultation on areas of concern. The Company Secretary's Office is also the permanent face of governance within the organisation and plays an educative as well as facilitative role in relation to the executive management. (See also Paragraphs 66-68 below).
63. The developing practice of shareholders proposing resolutions to be moved before company annual general meetings reinforces the need for an independent company secretary. Companies facing such active shareholder measures have need of an arbiter of fair process in such matters who is independent of executive

management interest. The increased use of shareholder resolutions as a governance measure, a common phenomenon in the US, may be anticipated here in the UK, not least in the light of the impetus for shareholder activism provided by the Myners Review and anticipated in the forthcoming Companies Bill.

64. The non-executive advisory function provided by the Company Secretary's Office is designed to assist the non-executive directors in their tasks and facilitate the proper exercise of their strategic and monitoring functions. The system relies upon a close working relationship between the Company Secretary's Office and the non-executive directors. The corollary of this close working relationship is that the Company Secretary's Office must of necessity be distinct from and independent of executive management of the company.

Section E: Support – How can non-executive directors best be supported to perform their role?

65. In the clearly defined boundary and delegation model outlined earlier, the process of monitoring the delegated powers exercised by the executive management of the company can not be driven out of the that self-same executive management. By way of example, it is now widely accepted that a Remuneration Committee of independent non-executives should determine executive pay levels and that the information and advice provided to them to aid their decision-making should most appropriately be provided from remuneration consultants independent of the executive management and not from HR directors and others who report to those executives.
66. In the broader context therefore it is essential that non-executive directors receive advice and support that is independent of executive management. The role of the company secretary can readily be positioned in this fashion. At BP the Company Secretary's Office includes a cadre of senior professional staff who act as advisors to the non-executive directors. This suite of appropriately qualified professionals is able to interact with the non-executives in a collegial fashion, being of a calibre that could serve at director-level in their own right. The resource thus provided frees up the time of non-executive directors to focus on the key decision-making and monitoring aspects of their role, enhancing their capability by providing independent assurance and oversight of Board process. Information and its provision drives Board decision-making (**Qu. 27**); the independent Company Secretary function ensures that information can be regulated and channelled to the Board appropriately. Independent expert advice (e.g. legal, accounting, etc.) can similarly be sourced independently of executive management through the Company Secretary for the benefit of or at the request of the non-executive directors.
67. Just as the roles of the Board and Directors need to be clearly stated, so too does the role of the Company Secretary. This will enable suitably qualified individuals to fill that role and be trained to carry it out. The Company Secretary will need support and, to the extent that this is not able to be provided in-house, we believe that professional service providers can better organise themselves to establish Board support groups. Given the Government's proposals in its White Paper "Modernising Company Law" that the requirement for private companies to have a Company Secretary be removed, a clearer, more substantive role may now emerge for PLC secretaries based on the experience most commonly gained through training within professional service providers.
68. In a number of listed companies the role of Company Secretary is combined with other executive offices. While historically this may have been acceptable, it has the potential to lead to conflicts of interest. Given the greater onus on Boards to work to ever higher standards of governance, we believe there are strong

arguments for assuring the independence of the Company Secretary, which would generally preclude combination with executive roles.

Proposal 6 – Independent Company Secretary to Support Non-Executives: The adoption of a best practice direction in the Combined Code that each Board member should have access to the services of the Company Secretary, which officer should – to the extent feasible, be “independent” of executive management. The intention is that this officer should be positioned as a source of support to the non-executives and the efficient functioning of the Board.

69. The embryonic professional **training, induction and development (Qu. 28)** programmes for inexperienced non-executive directors should be encouraged to grow, particularly for smaller PLC's. It is at the company-specific level, however, that training and induction is key. New appointees to Boards need to understand the role of the Board that they are joining so that they can play a full part (**Qu. 29**). This demands an understanding of the boundaries established for the Board's role - the delegations from the shareholders and the delegations to the executive management of the company. Regular reminders of the governance model employed by the Board and examination of whether that role is being fulfilled in practice is also beneficial.
70. Feedback processes on non-executive directors' performance tend to be informal in nature particularly after the initial period. Formal processes of assessment and guidance may be developed but should properly be held in confidence to the Board members as a whole. Given a fluid composition, the Nomination Committee can fulfil this performance assessor and guidance role (**Qu. 30**).

Section F: Smaller Listed Companies – in what ways is the position different for smaller listed companies?

71. An understanding of the role of the Board in each and every company is the key determinant. We consider that the Board governance model outlined in this paper based on defined boundaries and delegations of powers and authority is universally applicable regardless of the size and activities of the company. The boundaries and delegations, which determine the role of the Board and of the non-executives, will of course, vary, as will the processes by which the Board fulfils its role, but certain elements of process will be standard. For instance, to avoid conflicts of interest it is necessary that monitoring the performance of the executive management of the company should fall to the non-executive directors. We also consider that independence of the Company Secretary from the control of executive management is also important to support the Board in its task, although as noted in Paragraph 67 above, we recognise the cost issues and the need to find suitably qualified personnel to take on this role. However, while small companies may be deterred on cost grounds, it should be remembered that effective governance aids performance and efficiency; in this context the governance model advocated in this response is most certainly scalable to suit companies of all sizes.

Section G: International context – what can we learn from international experience?

72. **(Qu. 32)** The primary event of international significance in recent years is the Sarbanes-Oxley Act passed in the US during the course of this consultation process. The Act is the response of US legislators to the events at Enron Corporation, WorldCom and Arthur Andersen. Its purported regulation of the activities of all companies with a US listing means that most major corporations from around the world will now be compelled to order aspects of their governance processes to align with the demands of that legislation. Those jurisdictions in which underlying company law envisages structures fundamentally different from the unitary Board model of common law jurisdictions may find it hard to replicate the structures and processes required by that Act. Legislators here must reflect carefully on those events that lead to the adoption of the Sarbanes-Oxley Act and whether the reaction in the US is appropriate. This will need to be tested against UK company law and UK models.
73. Certain aspects of that new legislation (e.g. the elevation of the role of the Audit Committee over the Board of Directors as a whole) may be considered to run counter to fundamental principles of UK company law. In reflecting on international comparators and those aspects that should inform and influence the development of UK corporate regulation and practice, it is submitted that the developments in those countries whose corporation law shares the UK's fundamentals tenets (Australia, Canada and New Zealand) may be most appropriate. European Company Law developments driven by the EU are worthy of study, however, it is essential that reference back to the UK's own common law jurisdiction corporation law is made to ensure developments are appropriate.
74. **(Qu. 33)** In the past it has been suggested that either German-Japanese governance structures derived from block shareholdings or alternatively the Anglo-Saxon unitary board structure representing dispersed shareholders have driven superior performance. In fact, we are of the view that it is the effectiveness of processes that drive performance not structures *per se*. We believe that the key is that governance structures adopted by any corporation are fit for purpose and ensure accountability for corporate performance, or defined aspects of it, are clearly understood by the actors who participate in them. They must also be readily accommodated within the confines of the domestic law of the corporation concerned.