

Centrica is committed to sound principles of corporate governance and welcomes the opportunity to contribute to the development of governance principles relating to the role and effectiveness of Non-Executive Directors (NEDs). We believe that NEDs play a central role in corporate governance and support the desire to clarify and where necessary, strengthen their role to ensure best practice

The framework of corporate governance is enshrined in the Combined Code and the Listing Rules. Centrica agrees with the view that an approach based on best practice rather than regulation or legislation is the right starting point. We would suggest that any new developments in the sphere of corporate governance should be consolidated with existing principles. We also suggest that any changes take cognisance of developments from the company law review such that the end result is a complementary comprehensive system of company law and governance principles.

We would suggest that a set of general principles on corporate governance matters relating to NEDs and Boardroom practices rather than overly prescriptive rules is the right approach. In the spirit of transparency and accountability it may be desirable to require the Board to disclose whether and how it applies those principles.

In responding to this consultative document we have provided answers to the many questions raised and, where appropriate, made some general observations about corporate governance as a whole.

A: Role

What role should non-executive directors perform, and how does this compare to the present position?

Possible issues for comment:

1. What is the role of the board?

Boards should set the strategic direction and objectives of the Company. They should steer and direct the operation and performance of the company in the best interests of Shareholders whilst recognising the interests of other Stakeholders e.g. employees, customers, suppliers and others within wider social responsibility

obligations. The Board should determine the governance framework, monitor the system of internal control, evaluate performance and risk, take decisions on matters reserved to it pursuant to the execution of the strategy.

What is the role of the Chairman and how does it relate to the non-executive directors?

To steer and guide the board as a whole, to provide clear direction and focus and to encourage all directors to contribute fully in addressing all issues presented to the board. To maintain the integrity of the Company through effective corporate governance. To ensure an effective relationship exists between the NED and Executive Directors. To provide advice and support to the CEO and act as a sounding board.

2. What should be the key roles of non-executive directors on the board and what should be the balance between the different components?

To contribute to the development of strategy, to provide a strong and independent element in the Board decision making process, to challenge and enquire and to take the lead when potential conflicts of interest arise. To contribute to development and maintaining an effective governance framework within established best practice. To monitor the performance of the Executive and determine their remuneration.

Within a board, should all non-executive directors be expected to fulfil each of the different roles?

No, each director will bring different skills, experience and other attributes. They should complement each other and members of the Executive.

3. How does this compare to the present position?

Each company will have its own model. However, the NAPF guide for independent NEDs is a helpful template.

4. How independent do non-executive directors need to be for the different roles?

We see no reason why non-independent NEDs should not sit on the Board (if they can play a valuable role) provided the majority of NEDs are independent to ensure a well balanced board. A number of governance bodies and institutional shareholders have developed differing criteria for determining independence. We believe that there are varying shades of independence. Again we would urge flexibility as opposed to prescription and box ticking and whilst some criteria may clearly result in non independence, others should be left for the Board to decide.

5. What are the main potential conflicts of interest which may arise within a company where non-executive directors can play a role in protecting the interests of the company?

Takeovers, mergers and other corporate re-organisations or restructurings are areas where independent NEDs can play a significant role in ensuring that the best interests of shareholders as a whole are taken into account. Centrica also believes NEDs play an important role in judgements which may (or may be seen to) impact on Executives' performance and related remuneration, benefits and terms and conditions. Adoption and changes to accounting policies and accounting judgements is another area where NED perspective is important to ensure an appropriate balance.

What can be done to help non-executive directors to be effective in relation to these conflicts?

To ensure the interests of Shareholders as a whole are taken into account. Boards should establish – Audit, Remuneration and Nominations Committees. We agree with the provisions of the Combined Code relating to such committees. In addition, we suggest they should be chaired by independent NEDs.

What time commitment is needed for the role of Chairman and for non-executive director roles, and how far does this vary between different companies.

We believe as a guide, the Board should meet 8-10 times per year and the Audit and Remuneration Committee 2-4 times per year although this may well vary due to the size and diversity of the company. Additional time should be set aside for induction and regular company visits and access to managers below board level; and when other circumstances warrant the attention of the Board.

Are there any implications for the number of non-executive posts that one person can sensibly take on?

This will, to a large extent, depend on whether the individual has other executive responsibilities elsewhere. Professional NEDs may have a role to play. The balance of NED's with different and hopefully complimentary backgrounds is key. The number of appointments is something which could be prescribed in a Companies Articles. Ultimately it is a matter for the individual director and the company to decide.

6. Should there be a special role for a "senior independent" non-executive director?

Unsure what the role is where the company has an independent Non-Executive Chairman and independent Chairmen of the Audit, Remuneration and Nominations Committees or where there is a Deputy or Vice Chairman. In some instances the status of the Chairman (Exec or NED) is ambiguous, especially if

well paid. Deputy or Vice Chairman often clearly independent: automatically Senior NED. Where there is no Deputy or Vice Chairman it may be appropriate to have senior independent NED – if responsibilities clear.

7. Do you have comments on the proposed statutory statement of directors' duties, which does not seek to distinguish between the legal duties of executive and non-executive directors?

In support of the unitary Board, we believe there should be no distinction between the duties of executive and non-executive directors. We also believe this ensures commonality of interests. Executive Directors have an additional role as senior employees of the company.

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?

Possible issues for comment:

9. What are the key skills, knowledge and experience which are needed by non-executive directors to perform the role effectively, and how is this likely to change over the next, say, 10 years?
Are some skills essential and, if so, what are they?

Financial awareness, ability to understand complex matters and identify the key issues. The ability to maintain independence during Board debate thereby representing the interests of Shareholders as a whole. NEDs will bring different knowledge and experience to the Board to ensure the broadest possible range of complimentary input into Board discussions. Strategic thinking. Objective. Different skills for different companies (start-up, established; domestic/international; thriving/struggling).

10. What personal qualities and attributes are needed?

Senior level experience in the management of organisations but not necessarily corporate ones. Commitment, enquiring and open mind, team player, financial and commercial awareness and the ability to test and challenge management are all important. Independent minded but team player. Confidentiality. Integrity. Credibility. Openmindedness. Fairness. Trust.

- 11.** What sort of mix of experience and attributes is desirable on a Board?

Essential to have a broad mix.

- 12.** How easy is it to recruit non-executive directors with the right skills and attributes? Could recruitment and appointment mechanisms, including Nomination Committees, be improved?

It is becoming increasingly difficult as the extent of liabilities become more apparent coupled with the increasing difficulties in obtaining appropriate insurance cover. Difficulties exist due to time constraints and other responsibilities. The need for complementary skills and experience means there is a shortage of individuals willing to act. In addition the risk/reward ratio is unfavourable particularly when compared internationally.

- 13.** What could be done to widen the pool of potential non-executive directors and introduce greater diversity into appointments?

The pool should be as wide as possible drawing from business and professions both in the UK and overseas. Companies should seek to recruit the most appropriate individuals as NEDs.

What are the constraints on this? Is there scope for greater international representation on UK boards?

We can always learn from experience of alternative governance models and differing business experience. The biggest constraint on "international" is attending meetings. NEDs should be "representative".

- 14.** Are the rewards for non-executive directors appropriate, both in terms of levels of pay and the form that remuneration takes – e.g. cash/shares/share options? Are current pay levels a significant factor in whether good non-executive directors can be attracted?

As stated above, the risk/reward ratio is unfavourable. It is difficult to attract non UK NEDs at current UK NED fees level. We believe the current situation which does not allow performance related remuneration (in order to maintain independence) should continue because e.g. performance related (e.g. shares/options) may tie NED reward to Company success but also implies poor or no rewards when the Company most needs their attention and input.

- 15.** Do you have comments on the issue of risks or insurance provision for non-executive directors?

In view of the responsibilities and potential risks, comprehensive liability insurance is essential. It is however, increasingly difficult and expensive to buy – regardless of the probity of the Company.

C: Structures and accountability

Do existing structures and procedures facilitate effective performance by non-executive directors?

Possible issues for comment:

16. How is the Combined Code working in practice?

The Combined Code has generally worked.

In particular, how are the provisions on the balance between executive and non-executive directors and the role of independent non-executive directors working? We believe it works well in practice.

Is further definition needed of independence in the Combined Code and, if so, what would a sensible definition be?

The Combined Code should be kept under review. We would prefer not to see different definitions of independence by various institutions/governance bodies – would prefer to see one set – possibly NAPF as a starting point although, as mentioned in Q4 we would urge a degree of flexibility.

17. Do the recommended structures for board committees facilitate governance and an effective contribution by non-executive directors?

We agree with the current Combined Code requirements and would suggest all NEDs should sit on the Audit Committee if possible as this gives them a thorough insight into the Company. As mentioned in Q5 we suggest the Committees should be chaired by independent NEDs.

Are board meeting procedures working effectively?

We believe it is the role and responsibility of the Chairman in conjunction with Company Secretary to ensure Board procedures are in place and work effectively.

Do you have comments on board size?

We would regard 8-12 as the optimum size but recognise that this may vary from Company to Company.

- 18.** Do you have comments on the composition and duties of Audit Committees?
See above.

How effectively are Audit Committees working in practice?

The effectiveness of Audit Committees are dependent upon the support given by management and the demands made by the Committee and both internal and external auditors. Meetings should be conducted in the spirit of transparency and openness.

Do you see a need to strengthen the existing Combined Code provisions on Audit Committees?

We believe members of the Audit Committee/all NEDs should have unrestricted access to the Company Secretary and external auditors, other corporate advisors and senior employees. We suggest that companies should be required to report on how the Audit Committee complies with provision D3.2 (independence of auditors) of the Combined Code.

- 19.** Similarly, do you have comments on the composition, duties or operation in practice of Nomination and Remuneration Committees?

We agree with the current requirements and arrangements under the Combined Code.

- 20.** What processes are in place for setting objectives and reviewing performance against those objectives, for the board as a whole and for individual directors?

The Board as a whole should set the strategic objectives and review performance against those objectives – judged ultimately by the Shareholders. Individual executives will be subject to the performance evaluation process and performance rewards conducted by the Remuneration Committee. The Chairman is responsible for reviewing the performance of the NEDs.

- 21.** Could more be done to review performance? Should more information on board performance be reported to shareholders? Should companies provide more information on the performance of non-executive directors?

The performance of the NED is a matter for the Chairman and we would tend to query the practicability and benefit of reporting the performance of individual

NEDs. Ultimately, the performance of the board as a whole should be gauged by long term shareholder value creation.

- 22.** Are non-executive directors able successfully to challenge executive decisions or expose serious problems? Should it be made easier for them to do so and, if so, how?

To a large extent the NEDs are dependent on an honest open relationship with the Executive Directors. NEDs of the right calibre will challenge the Executive Directors when necessary, however, the only effective sanction a NED has is to resign if problems persist. It is essential that the NED's on the Audit Committee have the opportunity for private discussion with the external auditors and access to other corporate advisors (e.g. lawyers), the Company Secretary and other senior executives.

Two levels to challenge:

- one-to-one (e.g. pre-Board); and
- at Board level, either individually or collectively.

Several routes for information to find out about executive decisions and expose problems. Problems may be commercial/governance/perception etc., – vast variety.

It is important to have policies in place/delegated authorities, etc., and ensure that they are rigorously followed.

D: Relationships with shareholders and others

Do existing relationships with shareholders or others need to be strengthened?

Possible issues for comment:

- 23.** How well do relationships between non-executive directors and shareholders and stakeholders work, and could they be improved? For example, we would be interested to hear views on what the relationship might be between non-executive directors and institutional shareholders. How could this relationship be strengthened?

We believe that the Chairman and senior NED should be available to meet major shareholders to address any concerns they may have. However, we would question if it is right for NEDs to build/ strengthen relationships with individual institutional shareholders. Would impair/diminish independence and would increase the amount of time required of NEDs such that some individuals may be unwilling or unable to carry out the role. It may also be difficult to avoid giving them more information than is available to other shareholders.

- 24.** To what extent are Chairmen creating the conditions for non-executive directors to be effective? Is there more that they could do, by promoting constructive relationships, managing the discussion processes, encouraging challenging and effective contributions in board meetings and ensuring appropriate information flows, or otherwise?

Chairmen should ensure that all relevant information is made available and that the views of the directors, including the NEDs, are heard so that decisions reflect the views of the whole board. Chairman's role in appointing to Committees, consulting etc., and creating a transparent environment.

- 25.** What should be the relationship between non-executive directors and executive directors, and with senior management?

A good relationship with open and honest dialogue.

What should their relationship be with the Chairman and the Chief Executive?

As above.

What should their relationship be with key advisers to the company?

As above – see Q18. The Company Secretary should facilitate dialogue between the advisers and the NEDs. Plus access to own advisers if necessary

- 26.** How can Company Secretaries support effective performance by non-executive directors?

See above and:

Ensuring that board procedures are in place and that they work effectively. Timely circulation of accurate Board/Committee agenda's, papers and minutes etc. To act as the conduit for additional management information. Solid and open relationship with Chairman and the non-executives.

The provision of briefing and advice on technical issues, board procedures, best practice.

Arrangement of appropriate training.

E: Support

How can non-executive directors best be supported to perform their role?

Possible issues for comment:

- 27.** How much access to information from management do non-executive directors need to be effective?

It is essential that all the Directors are kept up to date with the affairs and activities of the Company. They need timely access to monthly key performance indicators and key issues (both internal and external) affecting the business.

In practice, are information flows and communication channels sufficiently open and unrestricted?

They need honest and open dialogue with Executive Directors and Senior Managers. The Company Secretary has a significant role to play in this area.

- 28.** What training and development opportunities are available? Could they be improved and, if so, how?

The Company Secretary should be responsible for making sure all the Directors are given timely updates on new regulations and legislation which affects the Company and in particular the roles and responsibilities of the directors. Internal induction, plus if needed, outside courses (e.g. IOD)

- 29.** Can induction for non-executive directors be improved?

As a matter of best practice there should be a proper induction process. This will no doubt vary from company to company and guidance on the development of a best practice may be helpful. Companies should then be required to report whether they have complied with the principles of the guide.

- 30.** Do non-executive directors get clear guidance on what is expected of them and do they get feedback on whether they are meeting expectations?

This is a matter for the Chairman.

F: Smaller listed companies

In what ways is the position different for smaller listed companies?

Possible issues for comment:

- 31.** To what extent do different factors apply in the case of smaller listed companies? Is different provision necessary?

The role and responsibilities of the Directors and of the Board is the same and therefore the role of the Non-Executive should recognise the size of the organisation and the resources available.

It may be that smaller companies need the freedom to use a NED as a paid consultant for specific purposes at specific times.

G: International context

What can we learn from international experience?

Possible issues for comment:

- 32.** What lessons can be learnt from international experience, either in terms of structures or behaviours?

Unitary Board with mix of Executive/Non-Executive promotes a collegiate style responsibility for decisions and consequences and should be maintained. We do not see any benefit in moving to a two-tier system.

- 33.** Do other models of corporate governance or different boardroom roles or dynamics contribute more to company performance?

See below

- 34.** Would it be beneficial to bring UK practice more in line with that in any other countries? If so, why and how?

We believe that we have a good framework of corporate governance in the UK and see no need for significant change. However, we recognise that benefits would arise by reviewing alternative practices which may contribute to the development of best practice in the UK

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