

Review of Non-Executive Directors  
Department of Trade and Industry  
Room 2142  
1 Victoria Street  
SW1H 0ET



13 September 2002

Dear Sirs

In response to your consultation questions on the role and effectiveness of non-executive directors, we provide comments on particular issues of importance where we have summarised our views under the headings below (and indicated the Question Numbers in your consultation paper to which they have particular relevance):-

**The Unitary Board**

(your questions 1 16 17 18)

Non-executive directors constitute one of the two components of the unitary board. We would like to add our support to what we believe is a consensus that the unitary board system is the most suitable for a UK listed company. This structure has been demonstrated to be generally effective over the last decade taken in conjunction with the Corporate Governance best practice initiatives that commenced with the Cadbury Report. We believe the system has served our shareholders and economy more effectively than the corporate governance regimes in many other countries. We would encourage you in your review of the role of non-executive directors to seek to preserve the current unitary approach and to avoid proposals that would tend to be divisive of the executive and non- executive elements of the board.

**The balance of Non Executives and Executives**

(your questions 2, 4, 9 10)

We believe the type of board balance envisaged by the Combined Code - with a balance of executives, non-executives and "independent" non-executives - is proving to be a sound model. At Invensys we have a majority of non-executives with a balanced background including directors from the USA and Europe which we regard as important for an international company.

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The requirement for independent non-executives on the important Remuneration and Audit Committees works well, we believe, in substantially all large listed companies. There may be occasional exceptions where investors or the public have taken a different view in relation to, for example, a remuneration policy, but the shareholder has always had the power to vote against Remuneration Committee appointments and now has a more specific power in relation to the report itself. We believe that existing procedures adequately provide for the expression of shareholder opinion in any exceptional case where best practice is not followed.

We recommend that no further expansion of best practice is required in this area.

### **Independence**

(your questions 4 9 10 11)

First, as set out above, we believe there is a role both for non-executives who are fully independent in the sense of the Combined Code and also for other non-executives who may or may not meet one of the currently circulating definitions of “independence”; they all bring value to the board and a contribution and experience different from that of the executives. Even those non-independent non-executives are of course, equally with all directors, bound to exercise independent judgement in the interests of the Company as a matter of company law. The justification for Code “independence” is that it makes it easier in the case of the Audit and Remuneration Committees for the members not only to be independent but also to be seen to be independent.

Secondly, whilst the concern in relation to the question of independence is readily understood, it is one only of a number of necessary characteristics for a non-executive. Of equal or greater importance are the ability, integrity and strength of character of the non-executive in making, when the occasion demands it, an effective criticism or challenge in relation to an executive proposal. Hypothetically, there could be a wholly independent director (under the current checklists of non-independence now in circulation) who was personally incapable of exercising any influence. Conversely, there are many directors in listed companies who may fail one of the checklist points but whose ability and integrity enables him or her to make the required board intervention, despite the matter deemed to inhibit their independence.

We would recommend therefore that proposals should not be adopted whereby a list of prescribed matters is treated as raising a conclusive presumption of non-independence. Whether or not a director is independent should remain a matter for the judgement of the Board. At the most, the Board should be required as a matter of best practice to explain its reasoning in the event of the existence of any particular prescribed matters.

In particular, we would place low priority, in assessing independence, on length of service. Integrity is not diminished over time. It is more important that at least one non-executive has a full understanding of the history of the board's strategic approach and has perhaps experienced more than one business cycle in the relevant company and industry.

### **The relationship between Non-Executives and Shareholders**

(your questions 7-23)

You ask whether the link between non-executives and institutional shareholders should be strengthened.

There is already a significant additional line of communication through the role of senior independent non-executive director and we believe that caution should be exercised before giving any further formal influence to particular groups of individual shareholders that are already believed by ordinary (small) shareholders to be unfairly privileged in access and information.

Most companies limit the number of people through whom it communicates with external investors. This typically includes the Chairman, the Chief Executive, the Chief Financial Officer and Chief Communications Officer (however titled). The reasons for this are that such communications are extremely sensitive both commercially and legally under the Financial Services and Markets Act and require a detailed and intimate knowledge of the operations of the Company. Since non-executives by definition are involved only with the highest level of information and are not in day to day contact with the Company, they are not well positioned for such a role.

We are aware that there is increasing contact between institutional investors and the Chairman of Remuneration Committees often in the course of formal consultation exercises undertaken ahead of changes in remuneration policy. This can be a helpful process and enables views to be canvassed before plans are finalised to avoid later misunderstandings. However, such exercises are demanding of non-executive time and necessarily require that the non-executive is supported by internal assistance from the Company, so it is not a purely non-executive activity. It is also capable of attracting criticism, possibly justified, from other smaller shareholders, including smaller institutions, which have not been consulted. We do not believe these or any similar contacts should be formal requirements.

### **General**

Your questions were numerous and wide-ranging covering many aspects of boardroom practice and procedure. We have not responded in detail to all of them as we are aware that many organisations and professional bodies are presenting submissions setting out detailed analyses of current issues and practices. As you will see from the

