

## **Lattice Group plc**

### **Response to Review the Role and Effectiveness of Non-Executive Directors Consultation Paper issued by Derek Higgs 7 June 2002**

#### **Section A. What role should Non-Executive Directors perform, and how does this compare to the present position?**

Key roles for the Board are to take responsibility for the overall strategic direction of the Company and the assessment of performance of the executive management. The Chairman's primary role is to manage the Board whilst the Chief Executive, as the most senior executive of the Company, manages the Company. The Chairman therefore is implicitly responsible for not only managing the Non-Executive Directors but also keeping them fully briefed and advised. The Chairman should be made responsible for ensuring that corporate governance best practice is embedded in the Board; the Chief Executive and Company Secretary should ensure that it is practised throughout the Company. The Chairman's style will differ but should in any event influence, through the Chief Executive, an open culture throughout the Company. The Chairman and the Board also need to be committed to sound administration and be assured by the Chief Executive and the Company Secretary that sound administration is in place across all key functions. The Chairman should be responsible for ensuring that there is a system for adequate succession planning at Board level, to be reviewed regularly by the Nominations Committee; the Chief Executive is similarly charged for management succession below Board level.

With respect to Non-Executive Directors, it is vital that each director is able to exercise independent judgement based upon their own commercial and/or technical expertise. This also applies to Executive Directors who should represent not only their own areas of business but, as elected directors of the Company, all shareholder interests. Non-Executives should also ensure that the Company makes a positive contribution to society and encourage the social dimension. They should challenge the Executive on strategic direction, the shape of the organisation and investment decisions as well as ensuring that appropriate controls are in place and good governance and sound administration is adhered to. To this end there needs to be a suitable range of skills amongst the Non-Executive Directors on the Board.

Non-Executives can play a particular independent role in areas such as pay and benefits for Executive Directors where conflicts of interest could otherwise arise. They should also have full and free access to internal and external advice, as necessary, in order to exercise sound judgement from an informed base.

With respect to other directorships, it is difficult to be prescriptive with regard to the number to be held as this will very much depend on the business and boardroom experience as well as the capability of the individual and his /her other commitments, including the number of days / evenings per week he /she is prepared to work. Should

the Non-Executive Chairman be prepared to work effectively full time, then it would not be unreasonable, given most companies (and most Chief Executives!) would not expect him / her to be in attendance more than 1.5 to 2 days per week, that a maximum of 2 to 3 chairmanships plus 1 or 2 Non-Executive Directorships would be acceptable; however the overall guidance must be that he / she has adequate time to devote to each Board. The Chief Executive and other Executive Directors should be allowed to take only one Non-Executive Director post. The number of Non-Executive Director posts that Non-Executives take on should not be formally limited in number as it will depend on whether the individual is in full or part-time employment and what other commitments are taken on by him / her but by way of guidance should not exceed 6.

With respect to identifying a senior independent Non-Executive Director, this is a necessity if the roles of Chairman and Chief Executive are combined. Where they are not and there is no Deputy Chairman, the Chairmen of the Audit and Remuneration Committees should be regarded as senior independent Non-Executives. (Of course shareholders should also be encouraged to approach the Chief Executive and Finance Director as well as the Chairman). Recognised senior Non-Executives (as set out above) can be of particular importance if there are any areas of disagreement or conflicts with shareholders, or between the Chairman and Chief Executive.

With respect to Directors' duties, the unitary board concept should continue and Directors' duties should not be re-stated to vary between Executive and Non-Executive Directors.

**Section B. What knowledge, skills and attributes are needed, and what can be done to attract, recruit and appoint the best people to Non-Executive roles?**

It is important that there is a balance of skills on the Board and a mix of business experience. A basic understanding of the financial implications of business decisions is important as well as a good, in-depth understanding of the Company's business. It is important that a Company induction programme and external training is given on appointment which must include visits to relevant businesses (in a group or on a one-to-one basis). They should also have unconstrained access to Executive Directors and senior management, and be encouraged to discuss issues involving the Company's business freely with them. It is essential that Non-Executive Directors are kept informed not only on relevant business issues but also by receiving analysts reports and information on shareholder feedback. They must also be kept fully aware of proposed legislative changes which may affect them (for example, corporate manslaughter) and be consulted by the Company if it is making comments on any proposed changes to Government departments and the like.

As far as personal qualities are concerned, it is important that Non-Executives have the ability to grasp often complex business issues and the strength of character to stand up to the Executive Directors if required. At least one Non-Executive Director should also have accounting or finance director experience. Specific knowledge and experience in business areas and issues such as health and safety may also be important.

Appointments of Non-Executive Directors should be led by the Chairman with the Nominations Committee and consulting with Executive Directors. In attempting to widen the field for Non-Executives, care needs to be taken that the mix of Non-Executives balances new talent with sufficient Board Room experience. In sourcing Non-Executive Directors from a wide pool, a search could well involve specialist senior managers from below Board level in the larger companies. Such managers may not necessarily have had PLC boardroom experience and would benefit from it and Boards could derive advantages from their knowledge, whilst recognising that PLC boardroom training will be an additional requirement.

Rewards need to be radically reviewed to reflect the level of input and time, including preparation time, and reputational risks accepted by Non-Executive Directors and Chairmen. Given that there can be periods in a Company's business when there may be a significant number of additional meetings eg: in a merger or major acquisition scenario, the basic fee should assume a specified number of meetings and preparation work (for Boards, Committees and any overseas travel) which would be augmented by supplementary fees for additional meetings. A possible benchmark would be the daily rate paid to a senior consultant of a major consultancy firm (see Appendix attached). Additional fees should also be paid for chairing Board Committees as a result of the increased time spent on Committee matters. Good Non-Executive Directors or Company Chairmen are as important as good Executive Directors and Chief Executives. Their remuneration should therefore reflect this and the fact, given the unitary Board concept, that their ultimate responsibilities are essentially no different to Executive Directors and the reputational risk could be considerable.

Up to one third of payments to Non-Executive Directors could be in shares but not share options. Fees must be set at a level that will attract the right calibre of person given the liabilities being assumed. Unless comprehensive insurance cover can be taken out, it will become very difficult to recruit Non-Executive Directors (although if criminal liabilities are imposed, insurance will have very limited cover in any event).

### **Section C. Do existing structures and procedures facilitate effective performance by Non-Executive Directors?**

The Combined Code provides a 'good governance' framework. As stated above, all directors should act in an independent way representing all shareholder interests.

The definition in the Combined Code of Non-Executive Directors being "independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement" is unsatisfactory in one respect in that best practice is that the Non-Executive Chairman and Deputy Chairman are not regarded as independent although this is not necessarily clear from the definition. Indeed, to facilitate the concept of independence, all Non-Executive Directors could be called 'independent' instead of 'Non-Executive'.

Board procedures and Committee structures should be reviewed regularly to ensure that they are effective and efficient for governance purposes. Also, it is important that e.g. the Head of Internal Audit (or someone independent of the Board) review with Non-Executives via a defined assessment process how they believe the Board is performing with the reviewer making an overall assessment of performance and any

specific recommendations he believes are appropriate to the Chairman for implementation.

With respect to the Audit Committee, the choice of Chairman of the Audit Committee is crucial and he /she must have extensive business experience and / or be a practising Finance Director (or recently involved in frontline finance). Inevitably the Audit Committee relies not only on the skill, integrity and judgement of the Finance Director and Internal Audit but also external auditors and at meetings Non-Executive Directors should be given an opportunity to question external auditors without Executive Directors being present. The Chairman of the Audit Committee should also have separate meetings with the Finance Director, Head of Internal Audit and external auditors prior to the interim and full year results. It is important that, for all Committees, papers are presented giving sufficient information without swamping members and here the role of Company Secretariat is important in ensuring timely, coherent and structured papers are prepared and presented.

As far as performance against objectives is concerned, the Chairman should monitor the performance of all Non-Executive Directors. Terms of appointment should be intended to be for no more than 3 years with the Nominations Committee reviewing performance before any proposal to reappoint is made for a further 3 year period (with an absolute maximum period of service of 9 years). However, in recommending appointments, the Nominations Committee should take into account the balance of skills at the Board at the particular time. Non-Executive Directors' fees should not be linked to performance (other than additional fees for 'extraordinary' Board meetings) whilst the pay of Executives should be part performance-linked relating to overall Company and individual performance against clearly identifiable targets.

Non-Executive Directors should be encouraged to challenge Executive decisions and bring the benefit of their own business experience to probe matters which come to them for review and approval. The Chairman should encourage their opinions and should be able to meet with Non-Executive Directors on a regular basis. At least once a year the Chairman should meet the Non Executives without the Chief Executive being present to assess the Board's and Chief Executive's performance and once a year with the Chief Executive present, to assess the Executive Directors' performance. Non-Executives should also be encouraged to discuss matters with the relevant Executive Director without the presence of the Chairman and/or Chief Executive if required. They should also be encouraged to request the presence of external advisers at the Board and Committee meetings to assist them with complex issues.

#### **Section D. Do existing relationships with shareholders or others need to be strengthened?**

Inevitably institutional shareholder meetings are usually held with the Chief Executive and Finance Director who have the detailed knowledge that shareholders are seeking. It is important that at least annually the Board has a presentation on investor relations with financial / PR advisors and the Company's brokers present if necessary. In any event, feedback by financial / PR advisors from all analyst / shareholder meetings should be circulated to all Board Members. (Indeed, Non-Executives should also be invited to analysts' meetings to understand the range of

questions put to the Executive Directors). Where this indicates any areas of concern, arrangements should be made, if required, for shareholders to meet with some or all of the Non-Executive Directors and senior managers. However, other than the senior independent Non-Executive Director (see Section A), no single Non-Executive Director should be singled out as a shareholder representative; all Non-Executives are there to represent shareholder interests and any such approach would undermine the role of not only the Chairman and senior Non-Executive Director but also the Chief Executive and Finance Director.

The Chairman should ensure all Non-Executives are kept informed at and in between Board meetings. It is key that all matters relevant to the Company's business (such as Treasury issues, HR, Pensions, Health and Safety etc and all matters which are not otherwise delegated) are regularly reviewed by the Board. However Non-Executives should also be encouraged to have discussions directly with the Executive Directors. It is also important that Board papers are of appropriate quality and submitted on a timely basis for proper consideration of issues and the Company Secretary is key here. The Company Secretary should also be the means to facilitate discussions and meetings and arrange appropriate external advice as required. The Company Secretary should report regularly to the Board on governance issues including policies and procedures and delegations so that the Non-Executives have comfort that procedures are in place. Part of the Internal Audit process will provide assurance that they are being followed. All written communications by Executives with Non-Executives should be forwarded via the Company Secretary.

**Section E. How can Non-Executive Directors' best be supported to perform their role?**

Non-Executive Directors (after appropriate inductions to the Company's business and external training if it is the first Non-Executive Directorship) need sufficient information to be able to make informed decisions but should not be swamped. The Company Secretary plays an important role in ensuring the format of information supplied is user friendly and that Non-Executives have access to all relevant facts.

It is important that Non-Executives have full access to Executive Directors and other senior staff and are encouraged to learn fully about the businesses. The Chairman should ensure that they receive clear guidance on what is required and that performance of the Board (including its Non-Executives) as a whole is reviewed on an annual basis as referred to in Section C.

**Section F. In what ways is the position different for smaller listed companies?**

This question is not relevant to Lattice Group plc.

**Section G. What can we learn from international experience?**

The UK Unitary Board concept should continue. The UK is at the forefront of 'good governance' and is a model in many respects for other jurisdictions; nevertheless the Chairman and the Board should reappraise governance issues regularly to ensure they continue to represent 'best practice' and, to this end, 'constant improvement' should always be sought.

**Appendix**

**Schedule of Consultants' Fees**

	<b>Large Consultants e.g. PwC</b>	<b>Strategy Consultants e.g. McKinsey</b>	<b>Boutique Consultants e.g. Academics</b>
<b>Partner Level</b>	2-4k/day	2-7k/day	10-20k
<b>Senior Management Level</b>	1-3k/day	2-4k/day	N/A