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cc Sir Adrian

ADDRESS TO THE ANNUAL CONFERENCE OF THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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THE ROLE OF DIRECTORS

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INTRODUCTION

The role of directors is a one of those subjects which lends itself, par excellence, to worthy generalisations. So I want this morning to take a very concrete look at a live workshop where many of the Cadbury concepts are being put to work and to tell you how we are getting on. The workshop is called Eurotunnel.

Nature of Company

- legally bi-national
- actually bi-cultural (English pragmatism and French Cartesian logic are unhelpful simplifications, but differences there are, to be ignored at your peril)
- twinned units quoted in London, Paris and Brussels plus ADR programme
- 616,000 'small' shareholders holding over 45% of share capital - 53% in France, 34% in UK, 13% spread elsewhere (no country larger than 2.7%). No single shareholder with more than 2.9%.
- bi-national/bi-lingual/bi-cultural management and workforce
- challenges:
  - balance between forces (TML, banks, railways, IGC/SA, Governments, EC etc.)
  - getting system open for service in fourth quarter 1993, and developing demand to win market share
  - ensuring shareholders are still the owners when all that happens

Why is all this important? Because conclusion is going to be that circumstances rather than regulation should determine what the Board of Directors needs to do, and how it ought to set about doing it.

THE JOINT BOARD

14 directors - Chairman, Deputy Chairman and Chief Executive, 10 non-execs, and two other executive directors who are MDs responsible respectively for the future transportation operation (Transco) and for Finance and Group Services.

Refer to page following p21 of Annual Report. Note range and diversity of background of the non-executive directors across the top of the page.

As a matter of observable fact none of the non-executives has any prior working relationship with Eurotunnel, nor do they have financial interests beyond their own shareholdings and those of the institutions they represent, apart from the less-than-munificent attendance fees which is the totality of their remuneration as directors.

However, I'm not sure why Cadbury believes these matters are important in establishing their 'independence'. Independent of who or what?

We need directors who <u>see themselves</u> as part of the team that is going to get us to achieve our goals. If you have directors of the right stature, whether executive or non-executive, they will ensure that they views are known. If you have the wrong directors, I question whether carefully worded definitions of independence are going to make them any less ineffective.

But it <u>is</u> important to understand different views in UK and France of directors' functions. Generally in major French public companies the Board comprises a majority of non-executive directors; often the sole executive director on the Board is the PD-G.

This may derive from the fact that many French companies do not have a wide shareholder base, but rather a series of cross shareholdings of a few key shareholders in each company. These key shareholders, often banks and financial institutions, can therefore have very complex family trees. (The famous 'noyau dur').

The fact that the particular shareholder conditions do not apply to Eurotunnel does not make the basic structure any less applicable in French eyes.

So much for that aside.

Split of Chairman and CEO essential to create Anglo-French balance. They are also respectively Chairmen of the French and UK holding companies and each plays a particular role in maintaining contact between meetings with non-executives from each country.

Beyond that, I do believe there is great merit in having the Chairman, whose primary focus is on the Board, able to take a somewhat more detached view than the chief executive, whose primary focus is on the management.

Joint Board meetings are in fact simultaneously the formal board meetings of the two quoted companies (EPLC and ESA) and the two concession holders (CTG and F-M). This presents no problem since the shareholders, the directors and the managements of the two sets of companies are identical.

BENEATH THE JOINT BOARD

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                   JOINT BOARD
                        |
   |--------------------|
TJB (4/5 each yr)      EXCO
   |                    |
   |--------------------|--------------------|
   |                    |                    |
Transco Board          PID        Gp Services Executive
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IMPLICATIONS OF A PREDOMINANTLY NON-EXECUTIVE BOARD

high time-commitment

between-meeting briefing essential

French quorum requirements

volume of information:

physical project progress
TML/claims
IGC/SA
banks/financial
creation of 'Transco'
- operations
- commercial
shareholder information
governments/EC

quality and circulation of Board papers

whenever time permits major issues generally put as a set of options to first meeting, to stimulate discussion at that meeting and subsequently. The outcome will then come back to second meeting as a management recommendation with a known degree of Board support.

ADVANTAGES

background and experience

sounding board and feedback function

concentration on priorities

leads to care in formulation of management recommendations

PLUS

'control and monitoring' functions (Non-executive meetings at end of each Board)

COMMITTEE FUNCTIONS

Genral comment on use of Committees. NOT a substitute for Board responsibility; they ARE a means of ensuring that a lot of busy people can ask some of their number to devote particular attention to important issues.

So Committee functions will reflect management needs.

ET has Board committees for:

audit
remuneration
risk management
safety
claims
technical committe now absorbed into TJB

Each is chaired by a non-executive director, and their membership and terms of reference are established by the Joint Board. Minutes of all committee meetings are circulated to all Board members, and major decisions are made not by committees but by Board on the relevant Committee's recommendation.

All Board Committee memberships are published in the Annual Report.

I emphatically do NOT agree with Cadbury recommendation that the chairmen of Audit and Remuneration committees should report to shareholders.

The Board has, and must be seen to have, collective responsibility for all its functions.

How it chooses to allocate its work is a matter for the Board's internal administration, under its Chairman.

Certainly shareholders are entitled to know how the work is being carried out, and by whom.

But reports to shareholders should be made by the Chairman on behalf of the full Board. Questions may then be referred by the Chairman to individual directors or executives, including committee chairmen, but that is a far cry from the dangerous road proposed by Cadbury

Let's turn now to look in a little more detail at how the Committees work.

AUDIT COMMITTEE

I can easily be persuaded that an audit committee is an essential component of any well organised Borad. In Eurotunnel's case there is a particular need because of the complexity of meeting our bi-national statutory requirements. Its terms of reference are however fairly standard for a public company with shares quoted on several stock exchanges

The Audit Committee has a membership of 5 directors; four of them are non-executive (two French, two British), the fifth being the Group Chairman. The Committee is chaired by Denis Child, Chairman of the London Clearing House Ltd and director of National Westminster Bank.

The Chief Executive, myself as Managing Director, Finance and the Financial Controller attend all meetings of the Committee.

The auditors can be invited to attend meetings for consultation at the discretion of the Committee, and always attend when the annual and half-yearly financial statements are being considered.

At the end of each meeting with the external auditors, the Chairman asks all the executives to leave the meeting to provide an opportunity for the auditors to discuss with the non-executives any matters which might be difficult to broach in the presence of the executives. If anything notable has been said on those occasions, I have yet to hear about it!

The Group has also established an Internal Audit function which approves and monitors procedures and controls within the Group, and has a strong 'value-for-money' remit. The purpose, authority and responsibility of the Internal Audit function are defined and agreed by the Audit Committee. The Head of Internal Audit is appointed and may only be removed by the Audit Committee, to whom he formally reports.

REMUNERATION COMMITTEE

You will all be aware of the guidelines on Remuneration Committees recently issued by ProNed. These recommend that all listed companies should have such a committee to consider and decide upon the total remuneration of senior management.

So the emotive and well-publicised issue of director's pay and benefits can be seen to be decided upon by an impartial committee of board members who take into account the interests of shareholders and the current financial position of the company, as well as bringing their own experience and knowledge of such issues.

Eurotunnel's Remuneration Committee comprises 5 members: 4 non-executive directors [2 UK, 2 French] and the Group Chairman. The Chairman of the Remuneration Committee is Bernard Thiolon, Chief Executive of Crédit Lyonnais.

The Chief Executive and the Human Resources director contribute to the proceedings of the Committee. Executive directors, including the Chairman of Eurotunnel, are not present when their own pay and benefits are discussed. This means that decisions as to the pay and benefits of the Chairman and Chief Executive are made only by the non-executive directors.

The Remuneration Committee establishes and monitors the structure for pay administration for the Group, with particular emphasis on the objective of creating 'single status' terms of employment for French and British employees, whichever country they are working in.

The Committee also establishes the rules for allocation of share options to employees. The grant of options is seen as a highly efficient tool of management for the reward of eligible staff; the main grant of options is therefore linked to the annual Performance Appraisal process.

RISK MANAGEMENT COMMITTEE

Another key financial Committee of the Board is the Risk Management Committee. Eurotunnel now has some £4 billion of borrowings in four basic currencies under its credit agreement, over 70% of which is at short term interest rates. It also has from time to time up to £500 million in short term cash resources. The effective Treasury management of these large sums of money clearly calls for vigilance of a high order.

The RMC is chaired by a non-executive director and the other members are the Chairman, the Chief Executive, myself, the Director of Corporate Finance and the Financial Controller. Meetings are prepared and attended by the Treasurer and members of his staff.

The Committee meets monthly to review Treasury operations and establishes policies relating to credit, interest and currency risks, liquidity and maturities. Day to day implementation of these policies is then delegated to the Treasurer's department.

The minutes of each Risk Management Committee are circulated to the Board along with details of any changes to the mandates relating to hedging operations.

One rule that might be of interest is that the Treasury mandates last only until the next meeting, i.e. they need to be renewed and <u>re-signed</u> at each meeting to ensure that they cannot be automatically carried forward.

OTHER COMMITTEES

I've dwelt in some detail on the committees that will be found necessary for most well-ordered companies, although I suspect that the equivalent of our Risk Management Committee is still a lot rarer than it ought to be. Any bets that it will be next on the list of what the well dressed Board is wearing this season?

Equally important, but not calling for the same amount of detail for this audience, are the committees set up to deal with issues which are more specific to Eurotunnel.

I emphasise again the importance of keeping the Board structure sufficiently flexible to able to respond to <u>actual</u> needs.

Mention too the scrutiny the Board applies to each suggestion for a new committee. The Board has made it very clear it does NOT like having to use committees unless the need is clearly demonstrated.

SAFETY COMMITTEE

This process has lead to the creation of a safety committee to keep under review all matters concerning the safe operation of the Eurotúnnel Transportation System.

Chaired by Sir Christopher Tugendhat, formerly Chairman of the Civil Aviation Authority.

Demonstration of the central role that safety issues play and will continue to play in Eurotunnel's activities.

CLAIMS COMMITTEE

Likewise a very different set of considerations has led to the formation of a claims committee that acts as the sounding board for all matters relating to the strategy of our contractual battles with TML.

This committee normally meets on the day preceding Joint Board meetings so that its deliberations on the most up-to-date position can be reported to the full Board.

THE DIRECTORS' ROLE - A PRAGMATIC ANALYSIS

What lessons from our Eurotunnel workshop?

First, a pragamatic analysis of what the Board <u>actually</u> does.

Personal 'order of importance ' listing would be:

- support for management
    + antennae to third parties
    + sounding board for 'political' decisions
    + responsibility for major policy decisions
    + Eurotunnel 'lobby' of prominent opinion formers
- representative of shareholders generally ('noyau dur' certainly exists, but institutional directors show high degree of awareness of needs and concerns of small shareholders).
- monitor/watchdog

CONCLUSIONS

So what do I conclude:

First and foremost that the Directors - executive and non-executive - should see themselves as a single team working towards a common objective.

The moment that ceases to be the case you've already got a major problem which it is not certain that regulation is going to be able to do much about.

PART of that common objective is to have a proper set of checks and balances in the conduct of the Company's affairs.

Key parts of that structure of checks and balances are:

- a Chairman whose functions are different from those of the Chief Executive,

- and a body of non-executive directors of sufficient stature and numbers to be able to make their voice heard if needed. The crucial issue is always going to be the stature of the non-executives. I suspect the number of people with the capacity to fill that complicated role in a truly effective way is quite limited.

BECAUSE they are an integral part of the Company's management structure, the non-executives must be able to operate in a way which is tailor-made to the Company's needs - which will themselves change over time.

It is NOT clear that regulation as to the required form of the Board will assist this, and there must be a risk that it will work actively against it

So any further move in the direction of regulation of structure should start with a rigorous analysis of:

- the danger that is being guarded against
- the extent of that danger
- the price for those companies which have no need of the protections being sought
- the alternatives available

It is not evident that two tier boards, for all their theoretical benefits, would actually contribute anything to the matters we are discussing

I trust that this has enabled me to deal, directly or indirectly, with the principal questions put to me in the conference programme.

I realise that are three matters which I regard as non-issues which I have not covered. Who signs the accounts? Should the CFO be on the Board? And should he have any special legal responsibilities?

- It doesn't matter who signs the accounts if the Board has a proper understanding of its responsibilities

- yes, I think that generally the CFO should be on the Board, but it's not a big issue provided he attends. It was only last year that I went on to the Eurotunnel main Board. I have however always attended the whole of all main board meetings (except for that part reserved for non-executives) and never felt myself inhibited.

- I believe that any director already carries special responsibility for those matters in which he can be expected to have particular expertise.

For the rest, I believe it is for shareholders, and particularly for the institutions, to be close enough to their investee companies to know whether or not the Chairman is or is not leading a united Board, and more particularly whether the Board is organised in a way which is responsive to the Company's needs.

If the answer to either question is no the shareholders have the solution in their own hands.

But if the Board <u>is</u> united, and <u>is</u> addressing the issues it ought, then "if it ain't broke, don't fix it!"