



**european corporate governance institute**

## **Directors' Remuneration in Listed Companies**

### **UNITED KINGDOM\***

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\* The information and opinions included in this document are not intended to provide legal advice, and should not be relied on or treated as a substitute for specific advice concerning individual situations. The law, regulation and best practices are stated as they stood at 30 June 2003.

# Questionnaire

Answers to this questionnaire should be given from the perspective of provisions included in national laws, regulations and exchange rules, and of best practices as recommended by either official reports or corporate governance codes.

## 1. General

**1.1 Please indicate, as a general reference, the laws, case law, regulations, exchange rules and best practices concerning directors' remuneration in your country with respect to listed companies. Please indicate where these provisions (such as, for example, exchange rules) apply only to domestically-incorporated companies.**

- Companies Act 1985 (as amended, particularly by the Directors' Remuneration Report Regulations 2002) and (with reference to the energy sector) the Utilities Act 2000
- Listing Rules, adopted by the Financial Services Authority, available on <http://www.fsa.gov.uk>
- Combined Code: Principles of Good Governance and Code of Best Practice, Committee on Corporate Governance, May 2000, available on <http://www.fsa.gov.uk> The non-statutory Code sets the principles of good corporate governance for UK listed companies

There is some overlap between general company law and the Listing Rules: all listed companies incorporated in the UK must comply with general company law, as set out in the Companies Act, 1985 and with the Listing Rules. The two sets of rules are complementary but there are some overlaps.

Most Listing Rules concerning directors' remuneration apply only to companies incorporated in the United Kingdom: (Listing Rules 17.12 and 17.14).

**1.2 As to best practices, please specify whether they are described in either a private (voluntary or non-statutory) code or other official report, and whether a "comply or explain" principle is applicable to compliance with the relevant provisions by listed companies. Where the "comply or explain" principle applies, please indicate, where such evidence is available, whether companies generally comply with best practices.**

### **(a) Best Practices and "Comply or Explain"**

The Combined Code does not form part of the Listing Rules but is included as an appendix to the Rules. The Rules require listed companies to make a disclosure statement in their annual report and accounts as to how they have applied the principles of the Code, whether or not they have complied with its provision and, if the recommendations have not been complied with, to provide an explanation.

### **(b) Evidence of Compliance with Best Practice**

In July 1999, PriceWaterhouseCoopers produced a report commissioned by the Department of Trade and Industry on the "*Monitoring of Corporate Governance Aspects of Directors of Remuneration*" which examined compliance with selected aspects of the Greenbury Code on Best Practice and the Combined Code. With respect to the Combined Code, and using annual reports and accounts and notices of AGMs in respect of companies in the FTSE All-Share Index for

financial period ended between 26 December 1998 and 31 March 1999, it reported the following:

(1) On the Combined Code's recommendation that remuneration committees be composed of a majority of non-executive directors (Q 4.2 below):

- Remuneration Committees with a majority of Non-Independent Non-Executive directors 6%
- Remuneration Committees chaired by the Chairman of the Board of Directors 27%
- Remuneration Committees with Executive Directors 3%

(2) On the Combined Code's recommendation that services contracts be of one year or less (section Q4.7 below):

- N. of Contracts of Employment of duration one year or less 60%
- N. of Contracts of Employment of duration between more than one year and less than/equal to two 39%
- N. of Contracts of Employment of duration of more than two years 1%

More generally, in 1999, a report produced by Pensions and Investment Research Consultants (*Compliance with the Combined Code*) indicated that listed companies have largely complied with the Code, although compliance rates diminish among smaller listed companies (cited in P. Davies, *Introduction to Company Law*, Oxford University Press, (2002) 131-132).

**1.3 Please describe in summary: the institutional structure for adopting executive remuneration rules or best practice codes; and any major proposals for reform concerning directors' remuneration.**

**(a) Institutional Structure**

The Committee on Corporate Governance's Combined Code is a development of the Committee's Final Report and from the Cadbury and Greenbury Reports. The Committee's remit was agreed with the sponsor organisations - the London Stock Exchange, the Confederation of British Industry, the Institute of Directors, the Consultative Committee of Accountancy Bodies, the National Association of Pension Funds and the Association of British Insurers. The Combined Code, issued in final form, includes a number of changes made by the London Stock Exchange, with the Committee's agreement, following the consultation undertaken by the London Stock Exchange on the committee's original draft. (Hampel Report Annex 1; Combined Code Preamble 2)

The Listing Rules, which require listed companies to follow a "comply or explain" policy with respect to the Combined Code, are adopted and administered by the UK Listing Authority, which is the statutory UK competent authority for listing and an integral of the UK Financial Services Authority (the FSA). The FSA, and thus the UKLA, operates under the statutory framework of the Financial Services and Markets Act 2000.

**(b) Reform**

The July 2002 UK government White Paper "*Modernising Company Law*", which is designed to set the parameters for a reform of UK company law which will result in "significant modernisation and reform" (White Paper, Summary, at 8), reported that the UK government remained committed to having remuneration set by the board of directors but also found that effective disclosure and accountability to shareholders was essential (White Paper, para 3.21). In August 2002 specific reforms were made to the Companies Act 1985 with respect to the enhancement of transparency and accountability for listed companies (discussed throughout this questionnaire). In particular, under the new regime listed companies will be required, as a matter of company law, to: publish a report on directors' remuneration as part of the annual reporting

cycle; disclose within the report details of individual directors' remuneration packages, the company's remuneration policy and the role of the board and remuneration committee in this area; and put an annual resolution to shareholders on the remuneration report. The current Listing Rules on disclosure of directors' remuneration will be amended accordingly.

The UK government has also accepted in the White Paper that while the Combined Code should remain non-statutory, a Standards Board (developed from the current Accounting Standards Board) should be designated as responsible for keeping the Combined Code under review and for making rules requiring companies to disclose whether they have complied with the Code (White Paper, paras 5.7 and 5.11-5.14).

In August 2002 specific reforms were made to the Companies Act 1985 with respect to the enhancement of transparency and accountability for listed companies by the Directors' Remuneration Report Regulations 2002. In particular, under the new regime listed companies are required, as a matter of company law, to: publish a report on directors' remuneration as part of the annual reporting cycle; disclose within the report details of individual directors' remuneration packages, the company's remuneration policy and the role of the board and remuneration committee in this area; and put an annual resolution to shareholders on the remuneration report. The current Listing Rules on disclosure of directors' remuneration (Listing Rule 12.43A), which overlap in certain respects with the new regulations, will be revised to reflect the new Companies Act Remuneration Report regime. The UK Listing Authority has stated that the disclosure rules will probably be removed, but that any revision will be undertaken as part of the general reform of the Listing Rules which is currently underway. Until the Listing Rules are revised, listed companies will be required to comply with both regimes, notwithstanding the degree of overlap.

In June 2003, reflecting current public debate and mounting concern as to the award of rewards for failure, or valuable termination payments, to executives of failing companies, the UK Department of Trade and Industry published a consultation paper on "*Rewards for Failure. Directors' Remuneration - Contracts, Performance and Severance*". The paper sets out for consultation a range of options to (i) enhance best practices and (ii) for legislative changes with respect to termination payments. Underlying the paper is the need to improve shareholder scrutiny and accountability with respect to compensation and severance payments. With respect to best practices, the options suggested for extending current best practices (the pros and cons of which are discussed in the report) include: (i) restricting notice periods to less than one year (the industry standard is one year, although the Combined Code calls for periods of one year or less); (ii) capping the level of liquidated damages (or the payment, agreed at the time of contracting, to be paid in the event of severance); and (iii) extending best practices to cover the phasing of termination payments. The DTI has also asked for views on how best practice changes might be most effectively achieved - should review proceed through institutional shareholder guidance, for example, or via the Combined Code. The paper commends the approach taken by the Association of British Insurers and the National Association of Pension Funds, whose Guidance requires, for example, that boards of directors' calculate the potential costs of termination payments in monetary terms, particularly with respect to pension payments. With respect to legislative changes, the DTI has asked for views on the following options: (i) whether legislation should be introduced requiring contracts to include provisions which require the board to take into account underperformance when determining termination payments; (ii) whether legislation should be introduced limiting the statutory period for directors' contracts to one year (or three years on first appointment) (as discussed in Q4.7 below, directors' service contracts are subject to a five year statutory period, although this can be extended with shareholder approval); and (iii) whether legislation should introduce a prohibition on rolling contracts (rolling contracts are renewed on a daily basis and so always

have a particular notice period) which have a notice period in excess of the statutory requirement.

## **2. Disclosure**

**2.1 Are listed companies required to publish a remuneration report, indicating the details of the compensation paid to the members of the Board of Directors? How often must it be published and where is it retrievable?**

### **(a) Companies Act 1985**

Yes, as a result of the 2002 revisions to the Companies Act 1985 (set out in the Directors' Remuneration Report Regulation 2002) which come into effect for listed companies with respect to the financial year ending December 31 2002. Previously, there was no such requirement under general company law.

Directors are now required to prepare a Directors' Remuneration Report for each financial year, which contains the information specified in the new Schedule 7A to the Companies Act 1985 (Companies Act s234B(1)). Where there is a failure to produce the Report in accordance with the Companies Act requirements, every person who was a director of the company immediately before the end of the period for "laying and delivering" the report and accounts for the year in question is guilty of an offence and liable to a fine (s234B(3)). The Report must be approved by the Board of Directors and signed on behalf of the Board by a director or the secretary of the company (s234C(1)).

The company's auditors must include in their report on the annual accounts a report on the auditable part of the Directors' Remuneration Report and state whether, in their opinion, that part of the Report has been properly prepared in accordance with the Companies Act (s235(3)).

The Directors' Remuneration Report must be published on a yearly basis (Companies Act s234B(1)) and laid before the general meeting of shareholders for approval (s241 and s241A). Like the annual accounts, the directors' report, and the auditor's report on the accounts, the Report must be sent to every member of the company, every holder of the company's debentures, and every person who is entitled to receive notice of general meetings, within 21 days of the general meeting before which these documents are laid (s238).

A copy of the Directors' Remuneration Report, together with the annual accounts, the directors' report and the auditors' report must be filed with the Registrar of Companies before the end of the period for "laying and delivering" accounts, which for public companies is 7 months after the relevant accounting reference period (Companies Act s242 and s244).

Note: With respect to distribution, instead of sending the accounts, directors' report, and Directors' Remuneration Report to the entitled persons listed in Companies Act s238 (see above), listed companies are permitted to send such persons a summary financial statement of the relevant documents (s251). The summary financial statement must contain the following information with respect to the Directors' Remuneration Report:

- the statement of the company's policy on remuneration (see Q2.3 below);
- the Performance Graph (see Q2.3 below).

### **(b) Listing Rules/Combined Code**

Yes. The annual report and accounts required of listed companies must, under Listing Rule 12.43A (a) and (b), include: (a) a narrative statement of how it has applied the principles set out in Section 1 of the Code, providing an explanation which enables its shareholders to evaluate how the principles have been applied; and (b) a statement as to whether or not it has complied throughout the accounting period with the Code provisions set out in Section 1 of the Combined Code. Where the company has not complied with the Code, or complied with only some of the Code's provisions, or, in the case of ongoing requirements, complied for only a part of an accounting period, it must specify the provisions with which it has not complied, the period of time over which non-compliance continued, and give reasons for the non-compliance. In addition, the annual report and accounts must, under Listing Rule 12.43A(c) contain a report to the shareholders by the Board containing the disclosure set out in the Listing Rules (see Q2.3).

As a result, the publication and access requirements track those applicable to the annual report and accounts: Listing Rule 12.41 requires that the report and accounts be published as soon as possible after the accounts have been approved, and in any event within six months of the end of the financial period to which they relate (in exceptional circumstances, the UK Listing Authority may grant an extension).

The auditors must review certain aspects of the financial disclosure made in the 12.43A(c) directors' report and the extent to which the statement required under Listing Rule 12.43A(b) with respect to certain aspects of the Combined Code.

Note: In light of the 2002 revisions to the Companies Act with respect to the preparation of a Directors' Remuneration Report, these provisions will change to reflect the new regime.

The Combined Code contains a number of recommendations on the publication of the remuneration report. In particular, the company's annual report should contain a statement of remuneration policy and details of the remuneration of each director (Combined Code B.3). Under B.3.1, the Board should report to the shareholders each year on remuneration. The report should form part of, or be annexed to, the company's annual report and accounts, set out the company's policy on executive directors' remuneration, and draw attention to factors specific to the company (Combined Code B.3.1 and B.3.2).

### **(c) Utilities Act 2000**

Particular requirements apply to the energy sector (particularly gas and electricity companies) following concerns as to excessive remuneration in the privatised utilities sector. Under s61 and s97 of the Utilities Act 2000 gas and electricity companies "authorised by license to carry on activities subject to price regulation" are required to make a statement on remuneration to the Gas and Electricity Markets Authority. This statement, which is designed to show the connection, or lack thereof, between remuneration and services standards, must contain the following:

- disclosure as to whether remuneration was paid to directors as a result of "arrangements". "Arrangements" cover arrangements for linking directors' remuneration to levels of performance with respect to services standards;
- disclosure as to when the arrangements were made;
- a description of the services standards;
- an explanation of the means where by levels of performance with respect to service standards are assessed;
- an explanation of how remuneration is calculated.

Remuneration covers all forms of payment, including benefits such as share options.

With respect to publication, the statement must be published by the company in a manner as it “reasonably considers” will secure adequate publicity. The Gas and Electricity Markets Authority which receives the report (see Q 2.2) may publish the statement in such manner as it thinks appropriate.

## **2.2 Must these reports be submitted, or their submission recommended, to a Securities Market Regulator or to a public authority responsible for collecting these documents?**

### **(a) Companies Act 1985**

See Q2.1 above on delivery of the directors’ remuneration report to the Registrar of Companies.

### **(b) Listing Rules/Combined Code**

The Listing Rule regime has not, as yet, reflected the 2002 changes to company law to which listed UK incorporated companies are, in any event, subject. All listed companies are required to publish their annual report and accounts, which will reflect the remuneration information required under Listing Rule 12.43A, as soon as possible after the accounts have been approved but no later than six months after the end of the financial period (Listing Rules 12.42).

### **(c) Utilities Act 2002**

The remuneration statement discussed in Q2.2 must be submitted to the Gas and Electricity Markets Authority as soon as reasonably practicable after the end of the financial year.

## **2.3 What information on directors’ remuneration, individually and collectively, and on the remuneration committee, must be included, or is recommended to be included as best practice, in the financial reports? Please include in your answer any specific requirements which apply to particular elements of remuneration, such as stock options, bonuses, and termination payments.**

### **(a) Companies Act 1985 Disclosure Requirements for Directors’ Remuneration Report**

(1) Information Not Subject to Audit (Companies Act 1985, Sch 7A, Part 3, s2-5)

(i) Remuneration Committee

- Directors’ and Advisers

Where a committee of the directors’ has considered directors’ remuneration for the relevant financial year, the Directors’ Remuneration Report must name each director who was a member of the committee at any time when the committee was considering remuneration (s2(1)(a)). The Report must also name any person who provided the committee with advice or services that materially assisted the committee and state the nature of any other services that person provided the company with during the relevant financial year and whether that person was appointed by the committee (s2(1)(b) and (c)).

(ii) Remuneration Policy

- Statement of Company Policy/Performance Conditions

The Directors’ Remuneration Report must include a statement of the company’s remuneration policy for the following financial year and for subsequent financial years (s3(1)). The statement must include the following:

- for each director, a detailed summary of any performance conditions to which any entitlement to share options or under a long term incentive scheme is subject (s3(2)(a));
- an explanation of why such performance conditions were chosen (s3(2)(b));
- a summary of the methods used in assessing whether the conditions are met and an explanation of why those methods were chosen (s3(2)(c));

- where the performance conditions involve a comparison with factors external to the company: a summary of the relevant factors; and, if any factor relates to another company or companies or an index, the identity of the companies and the index (s3(2)(d));
- a description of, and explanation for, any significant amendment proposed to be made to the terms and conditions of any entitlement of any director to share options or under a long term incentive scheme (s3(2)(e));
- if any entitlement of a director to share options or under a long term incentive scheme is not subject to performance conditions, an explanation as to why (s3(3)(f)).

The policy statement must also, in respect of each director's remuneration terms and conditions, explain the relative importance of those elements which are, and are not, related to performance (s3(3)). Finally, the statement must summarise and explain the company's policy on the duration of contracts with directors and on notice periods and termination payments under such contracts.

#### - Performance Graph

The Directors' Remuneration Report must also contain a performance graph which sets out the total shareholder return of the company on the class of equity capital, if any, which caused the company to be defined as listed (s4(1)).

Under s4(1)(a) and (b), s4(2), and s4(3), the graph is to be constituted as follows:

A line graph must show for (i) a holding of shares of that class of the company's equity share capital whose listing or admission to dealing has resulted in the company being listed for the purpose of the application of the remuneration report requirement and (ii) a hypothetical holding of shares, made of shares of the same kinds and number as those by reference to which a broad equity market index is calculated, a line drawn by joining up points plotted to represent for each of the financial years over a five year period, of which the last is the relevant financial year (to which the Report relates), the total shareholder return on that holding. It must also state the name of the index used and the reasons for choosing it. Where the company has been reporting for less than five years, the period is 2, 3, or 4 years, as the case may be. In its first financial year, the period is the relevant financial year.

Total shareholder return is calculated as follows (s4(4)).

It must be calculated using a "fair method" which: takes as its starting point the percentage change over the period in the market price of the holding; makes specified assumptions as to reinvestment of income and funding of liabilities (see s4(5) and 4(7) below); and makes provision for any replacement of shares in the holding by shares of a different description. The same method must be used for each of the holdings.

The assumptions as to reinvestment of income (s4(5)) are, first, that any benefit in the form of shares of the same kind as those in the holding is added to the holding at the time the benefit becomes receivable and, second, that any benefit in cash (such as dividends), and an equivalent amount of any non-cash benefit (excluding shares) is applied, at the time the benefit becomes receivable, in the purchase, at their market price, of shares of the same kind as those in the holding, and that the shares purchased are added to the holding at that time.

The assumption as to funding of liabilities (defined as a liability in respect of any shares in the holding or arising from the exercise of a right attached to any of those shares) is that, where the holder has a liability to the company of whose capital the shares in the holding form a part, shares are sold from the holding: immediately before the time by which the liability is due to be satisfied; and in such numbers that, at the time of the sale, the market price of the shares sold equals the amount of the liability in respect of the shares in the holding that are not being sold (s4(7) and (8)).

- Service Contracts (see also Q4.7)



The following information must be provided under s5 in respect of the contract of service or contract for services of each person who served as a director at any time during the relevant financial year:

- the date of the contract, the unexpired term, details of any notice periods;
- any provision for compensation payable upon early termination;
- details of other provisions in the contract as are necessary to enable members of the company to estimate the liability of the company in the event of early termination.

(2) Detailed Audited Financial Information (with respect to emoluments, share options, long term incentive plans, pensions, compensation, and excess retirement benefits with respect to each director and, in particular cases, past directors):

(i) Emoluments (for each person who has served as a director at any time during the relevant financial year) (Companies Act 1985, Sch 7A, Part 3, s6(1)-(4))

In tabular form in respect of each director:

- total amount of salary and fees (s6(1)(a));
- total amount of bonuses (s6(1)(b));
- total amount of expenses chargeable to UK tax (s6(1)(c));
- total amount of compensation for loss of office and other payments in connection with termination of qualifying services (s6(1)(d));
- total estimated value of non-cash benefits not covered elsewhere (s6(1)(e));
- total amount of (a)-(e);
- in addition, the total amount from (a)-(e) must be shown for each director for the previous financial year (s6(2)).

The Report must also specify the nature of any non-cash elements of the remuneration package (s6(3)).

(ii) Share Options (for each person who has served as a director at any time during the relevant financial year) (Companies Act 1985, Sch 7A, Part 3, s7-9)(see also Q2.4 and 2.5)

Detailed information is required on the share options granted to each director. This information must, however, be aggregated and simplified where the directors are of the opinion that full disclosure would result in “excessively lengthy” reports (s7(2) and s9(1)). The rules on aggregation and simplification are set out in s9(1) which provides that: the share option information provided under s8(a)(see below) need not differentiate between share options having different terms and conditions; the disclosure required in respect of unexpired share option in relation to price paid and exercise price (8(c) below) and unexpired options (8(g) below) may be aggregated and disclosure made of weighted average prices of aggregations of share options; the disclosure required in respect of unexpired share options in relation to exercise date and expiry date (8(c) below) may be aggregated and disclosure made of ranges of dates for aggregations of share options. There are, however, restrictions on aggregations. Under s9(2), aggregation is not permitted in respect of (i) share options in respect of shares whose market price is below the option exercise price at the end of the relevant financial year and (ii) share options in respect of shares whose market price at the end of the relevant financial year is equal to, or exceeds, the option exercise price. Finally, under s9(3) full disclosure must be made in respect of share options which, during the relevant financial year, have been awarded or exercised, or been subject to a variation of terms and conditions.

In tabular form in respect of each director:

- the number of shares subject to a share option at the beginning of the relevant financial year (or, if later, on the date of the director’s appointment as a director) and at the end of the relevant financial year. Differentiation should be made between share options with different terms and conditions (s8(a));

- information identifying: those share options awarded in the relevant financial year; those exercised in that year; those that have expired unexercised; and those whose terms and conditions have been varied in that year (s8(b));
- for each unexpired share option: the price paid, if any, for its award; the exercise price; the exercise date; and the expiry date (s8(c));
- a description of any variation made in the relevant year to the terms and conditions of a share option (s8(d));
- a summary of any performance criteria upon which the award of an option is conditional, including a description of any variations made to these criteria during the relevant financial year (s8(e));
- for each option exercised during the relevant financial year, the market price of the shares in relation to which it is exercised at the time of exercise (s8(f));
- FOR each unexpired option at the end of the relevant financial year: the market price at the end of the year; and the highest and lowest market price during that year of each share subject to the option (s8(g)).

(iii) Long term incentive plans (for each person who has served as a director at any time during the relevant financial year, but excluding any information already provided under the share option rules) (Companies Act 1985, Sch 7A, Part 3, s10-11)

A long term incentive scheme is essentially one under which the conditions subject to which awards are made cannot be fulfilled in one financial year. Bonuses linked to performance in a particular year, compensation for loss of office and other termination payments, and retirement benefits are excluded (s10(5)).

In tabular form for each director:

- details of scheme interests held by that person at the beginning of the relevant financial year (or, if later, on the date of the appointment of the director)(s11(1)(a));
- details of scheme interests awarded to the director during the relevant financial year (s11(1)(b)). If shares may become receivable in respect of the interest: the number of shares; the market price of the shares when the interest was awarded; and details of the qualifying conditions with respect to performance (s11(2));
- details of scheme interests held by the director at the end of relevant financial year (or, if earlier, on the cessation of the director's appointment) (s11(1)(c));
- for each scheme interest above: the end of the period over which the conditions for award have to be fulfilled and a description of any variation made in the terms and conditions of the scheme interests during the relevant financial year (s11(1)(d));
- for each scheme interest that has vested in the relevant financial year: the "relevant details" of any shares; the amount of any money; and the value of any other assets, that have become receivable in respect of the interest (s11(1)(e)). The "relevant details" required in respect of the shares covers: the number of the shares; the date on which the scheme interest was awarded; the market price of each of the shares when the interest was awarded; the market price of each of the shares when the interest vested; and details of the qualifying conditions with respect to performance (s11(3)).

(iv) Pensions (for each person who has served as a director at any time during the relevant financial year) (Companies Act 1985, Sch 7A, Part 3, s12)

- Where the pension scheme is a defined benefit scheme, details of any changes during the relevant financial year in the person's accrued benefits and of the person's accrued benefits as at the end of that year (s12(2)(a)). Details must also supplied with respect to the transfer value of the accrued benefits (s12(2)(b)-(d)).
- Where the pension scheme is a money purchase scheme, details of any contributions to the scheme in respect of that person paid or payable by the company for the relevant financial year or paid in that year for another financial year (s12(3)).

(v) Excess Retirement Benefits of Directors and Past Directors (Companies Act 1985, Sch 7A, Part 3, s13)

Details must be shown in respect of each person who served as a director at any time during the relevant financial year, or at any time before the beginning of that year, of that amount of retirement benefits paid to or receivable by the person under pension schemes, as is in excess of the retirement benefits to which he was entitled on the date on which the benefits first became payable or 31 March 1997, whichever is the later (s13(1)). Disclosure is not required where the increases were paid to all members of the pension scheme and were paid without recourse to additional contributions.

(vi) Compensation for Past Directors (Companies Act 1985, Sch 7A, Part 3, s14)

Disclosure must be made of the details of any significant award made in the relevant financial year to any person not a director at the time of the award, but who was previously a director of the company, including compensation in respect of loss of office and pensions (but excluding any information already given under s6(1)(d) (see above).

An explanation must also be given as to why such an award was made (s5(2)).

(vii) Sums Paid to Third Parties in Respect of Directors' Duties (Companies Act 1985, Sch 7A, Part 3, s15)

In respect of each person who served as a director during the relevant financial year, the aggregate amount of any consideration paid to or receivable by third parties for making available the services of the person as a director of the company or, while the person was a director of company, as a director of any of its subsidiary undertakings/as director of any other undertakings of which he was a director by virtue of the company's nomination/or otherwise in connection with the management of the affairs of the company or any such other undertaking.

## **(b) Listing Rules/Combined Code Requirements for Disclosure in Annual Report and Accounts**

See Q2.1 for the statements required with respect to compliance with the Combined Code.

Under Listing Rule 12.43(c), the annual reports and accounts must contain a report to the shareholders by the board on directors' remuneration. This must contain:

- a statement of the company's policy on executive directors' remuneration (c (i));
- for each director by name and for the period under review, the amount of each element in the remuneration package for the period under review, including, but not restricted to, basic salary and fees, the estimated money value of benefits in kind, annual bonuses, deferred bonuses, compensation for loss of office and payment for breach of contract or other termination payments. The total amount for each director for the period under review and for the corresponding prior period must also be disclosed, together with any significant payments made to former directors during the period under review. This information is to be presented in tabular form, together with explanatory notes where necessary (c(ii));
- in tabular form and for each director by name, information on share options (including Save As You Earn schemes)(c(iii)) (see also Q2.4 and 2.5);
- details of any long term incentive schemes, other than share option schemes previously disclosed, including: the interests of each director by name in the schemes at the start of the period under review; entitlements or awards granted and commitments made to each director under such schemes during the relevant period, the disclosure to show those which crystallize either in the same year or in subsequent years; the money value and number of shares, cash payments, or other benefits received by each director under such schemes

- during the relevant period; and the interests of each director in the schemes at the end of the period (c(iv));
- explanation and justification of any element of salary, other than basic salary, which is pensionable (c(v));
  - a statement of the company's policy on the granting of options or awards under employee share schemes and other long term incentive schemes, explaining and justifying any departure from that policy in the period under review and any change in the policy from the preceding year (c(viii));
  - detailed disclosure on defined benefit pensions schemes, particularly with respect to transfer value (c(ix));
  - disclosure on money purchase schemes with respect to details of the contribution or allowance payable or made by the company in respect of each director during the period under review (c(x)).

Note: as noted in Q2.1 these rules will change to reflect the 2002 changes to the Companies Act and the new requirement for a Directors' Remuneration Report. The UK Listing Authority has stated, however, that with respect to the share option disclosure required under Listing 12.43A(c)(iii), companies need only comply with the share option disclosure required under the 2002 Regulations.

The directors' report to shareholders recommended by the Combined Code should set out the company's policy on executive directors' remuneration, and draw attention to factors specific to the company (Combined Code B.3.2). It should also list the members of the remuneration committee (Combined Code B2.3). Full details should be supplied of all elements in the remuneration package of each individual director by name, such as basic salary, benefits in kind, annual bonuses and long term incentive schemes, including share options. Share option information should be given with respect to each director and, where grants are awarded under executive share option or other long term incentive schemes in one block, rather than in a phased fashion, the report should explain and justify this practice. Also included in the report should be pension entitlements earned by each individual director during the year: if annual bonuses or benefits in kind are pensionable, the report should explain and justify this practice. All of these elements of remuneration should be subject to audit (Combined Code, Schedule B 1, 2, 3, 6).

#### **2.4 Is timely disclosure required with respect to stock options, their vesting, exercise, and the sale of the relevant shares to third parties?**

Yes. For the disclosure required with respect to options, see Q2.5.

#### **2.5 What are the rules on disclosure of share transactions executed by the company's insiders (such as directors, officers, auditors, etc)?**

##### **(a) Companies Act 1985/Listing Rules**

The disclosure rules with respect to share and share option transactions arise from a combination of the disclosure required of directors for all companies under ss324-328 Companies Act 1985 and the Listing Rules (see also Q2.6).

Listing Rule 16.13 requires that a company must notify a Regulatory Information Service of any information relating to interests in securities that are, or are to be, listed which is disclosed to the company in accordance with the duty of directors to disclose shareholdings in own company under Companies Act s324 (which is extended by s328 to spouses and children) or which is entered in the company's register in accordance with Companies Act s325(3) or (4).

Section 324 (1) and (6) require that any person who becomes a director of a company at a time when he is “interested in” shares in the company (or a subsidiary of the company, or its holding company, or any other subsidiary of its holding company) commits an offence unless he discloses his interests, and the number of shares, to the company by written notice. Under s324 (2) and (6) such a person must also notify the company of any alteration (via: an event occurring while that person is a director in consequence of which the person ceases to be interested in the shares; that person entering into a contract to sell any such shares; the assignment by the person of a right granted by the company to subscribe for shares (ie: share option disclosure); and the grant to that person by another company in the group of a right to subscribe for its shares and the exercise of such rights (ie: share option disclosure)) in his interest in shares in the company (as defined previously) within five working days of the alteration. The notification must state the number or amount and class of shares involved and, under the Companies Act Sch 13, Part III, the price.

Very detailed and all-encompassing rules apply to the determination of whether a director has an “interest” in shares under Companies Act Sch 13. In effect it is: “defined elaborately and widely. In general, it includes an interest of “any kind whatsoever [Sch 13, Part I, para 1]” and whether actual or contingent [Sch 13, Part I, para 1-8]” (P. Davies, *Gower’s Principles of Modern Company Law*, 6<sup>th</sup> edition, (1997) 448). Exceptions apply where shares are held by nominees or trustees: a nominee for a director will not be “interested”, for example, but the director who uses a nominee will, although a director will not be “interested” when acting as a nominee for another person.

Failure to notify is an offence (with a possible prison sentence of two years) (s324(7)).

Share option disclosure is more specifically addressed by s325. Under s325, the company is required to keep a register for the purpose of s324: but, in addition, 325(3) and (4) address share option disclosure. In particular, the company is required, whenever it grants a director a right to subscribe for shares, to record against the director’s name:

- the date on which the right was granted;
- the period during which, or time at which, it is exercisable;
- the consideration (where applicable for the grant);
- the description of the shares involved, the number, and price to be paid.

Under s325(4), disclosure is required by the company, against the name of the director on the register, whenever the right is exercised, of the number of shares in respect of which the right was exercised, the names of the persons in whose names the shares are registered, and the number held in the name of each person.

In addition to the s324/325 disclosure incorporated in Listing Rule 16.13(a), disclosure is also required under Listing Rule 16.13(a) of

- the date on which the disclosure was made to the company;
- the date on which the transaction giving rise to the interest (or cessation of interest) was effected;
- the price, amount, and class of securities concerned, the nature of the transaction, and the nature and extent of the director’s interest in the transaction.

Listing Rule 16.13(b) addresses disclosure by “connected persons” (defined very extensively in Companies Act s346 to cover, inter alia, spouse, children, a body corporate with which the director is associated, and trustees of a trust the beneficiaries of which include the director and any of the aforementioned) of directors. It provides that such a person must, unless the

disclosure is already covered by 16.13(a), provide such disclosure as would be required under 16.13(a) were that person a director. The disclosure provided must track Rule 16.13(a) and identify the director, the connected person, the connection between them, and state the nature and extent (if any) of the director's interest in the transaction.

Share options are covered again under Rule 16.3(c). This provides that, unless the disclosure has already been provided under Rule 16.3(a) and (b), companies must notify a Regulatory Information Service of the following information:

- details of the grant to, or acceptance by, a director or a person connected with a director of any option (whether for the call or put or both) relating to securities of the company or of any other right or obligation, present or future, conditional or unconditional, to acquire or dispose of any securities in the company which are or will be listed or any interest of whatsoever nature in such securities;
- the acquisition, disposal, exercise or discharge of, or any dealing with, any such option, right or obligation by a director or a person connected with a director.

As with 16.3(b), the notification by the company must identify the director and, where relevant, the connected person and the nature of the connection between them, give the particulars specified above and state the nature and extent of the directors' interest (if any) in the transaction. Any notification required must be made without delay (by the end of the business day following the receipt of the information by the company).

In general, under Listing Rule 16.14, any notification required must be made without delay (by the end of the business day following the receipt of the information by the company).

Listing Rule 16.16 extends the disclosure required under 16.13 where dealing has occurred in a "close period", but is permitted under the exceptional circumstances exemption set out in the Model Code: companies must include in the 16.3 notification a statement of the exceptional circumstances in the light of which dealing was permitted. The Model Code is attached to the Listing Rules and sets out a code of dealing rules designed to ensure that directors, certain employees and persons connected to them do not abuse price sensitive information, and place themselves "above suspicion", particularly during the time leading up to a results announcement. As part of this dealing code, directors are prohibited from dealing in "close periods", as defined in the Model Code.

Finally, under Listing Rule 16.17, a company must require each of its directors to disclose to it all information which the company needs in order to comply with the requirements above (so far as that information is known to the director or could with reasonable diligence be ascertained by the director), as soon as possible and not later than the fifth business day following the day on which the existence of the interest to which the information relates comes to the director's knowledge. A company must require each of its directors, at such times as it deems necessary or desirable, to confirm that he has made all due enquiry of those persons who are connected with him. A company is not required to notify a Regulatory Information Service information which, notwithstanding compliance by it with these provisions, it does not have.

### **(b) Companies Act 1985 /Listing Rules and the Directors' Report**

The Directors' Report required of companies in their annual report and accounts as a matter of company law must, under Companies Act 1985, Sch 7, 2A, include disclosure as to the interests of directors, reflecting the Companies Act s324 disclosure. In addition, it must, under Sch 7, 2B contain basic disclosure on the grant of stock options. In particular, the Directors' Report must state with respect to each director whether, according to the register, any right to subscribe for shares of the company or another body corporate in the same group was, during the financial

year, granted to, or exercised by, the director or a member of his immediate family. The disclosure must include the number of shares in each body in respect of which the right was granted.

This company law requirement is also reflected in the Listing Rules which require the issue of a report and accounts which comply with the issuer's national law. More specifically, Listing Rule 12.43(k) requires that the report and accounts include, by way of note, the beneficial and non-beneficial interests of each director of the company disclosed to the company under the Companies Act 1985 together with any changes in those interests occurring between the end of the period under review and a date not more than one month prior to the date of the notice of the general meeting at which the annual accounts are to be laid before the company.

### **(c) Listing Particulars and Prospectuses**

Disclosure is also required in the listing particulars/prospectus. See Q2.6.

## **2.6 What information on directors' remuneration must be included in public offer prospectuses and listing particulars?**

With respect to listed companies, the disclosure required in the public offer prospectus tracks that required by the listing particulars (subject to the adaptations appropriate to the circumstances of a public offer).

The prospectus and the listing particulars must include:

- the total aggregate of the remuneration paid and benefits in kind granted to the directors by any member of the group during the last completed financial year under any description whatsoever;
- in the case of an issuer which is a company subject to the Companies Act 1985, interests (distinguishing between beneficial and non-beneficial interests) relating to securities which:  
(a) have been notified by each director to the issuer pursuant to section 324 or section 328 of the Companies Act 1985 (see Q2.5); (b) are required pursuant to section 325 of that Act to be entered in the register referred to therein (see Q2.5); or (c) are interests of a connected person of a director which would, if the connected person were a director, be required to be disclosed under (a) or (b) above, and the existence of which is known to or could with reasonable diligence be ascertained by that director (see Q2.5); or an appropriate negative statement;
- all relevant particulars regarding the nature and extent of any interests of directors of the issuer in transactions which are or were unusual in their nature or conditions or significant to the business of the group, and which were effected by the issuer during the current or immediately preceding financial year, or during an earlier financial year and remain in any respect outstanding or unperformed; or an appropriate negative statement;
- the total of any outstanding loans granted by any member of the group to the directors and also of any guarantees provided by any member of the group for their benefit (see Q3.3);
- details of any schemes for involving the staff in the capital of any member of the group;
- particulars of any arrangement under which a director of the issuer has waived or agreed to waive future emoluments together with particulars of waivers of such emoluments which occurred during the past financial year;
- an estimate of the amounts payable to directors of the issuer, including proposed directors, by any member of the group for the current financial year under the arrangements in force at the date of the listing particulars;
- details of existing or proposed directors' service contracts including the matters specified in paragraph 16.11, or an appropriate negative statement (see Q4.7);
- a summary of the provisions of the memorandum and articles of association of the issuer with regard to any power enabling a director to vote on a proposal, arrangement, or contract in which he is materially interested; any power enabling the directors, in the

absence of an independent quorum, to vote remuneration (including pension or other benefits) to themselves or any members of their body; borrowing powers exercisable by the directors and how such borrowing powers can be varied; and retirement or non-retirement of directors under an age limit.

### **3. Remuneration of The Board of Directors**

#### **3.1 Who fixes the board of directors' remuneration? What are the relevant procedures? (In two-tier systems, please refer to the supervisory board.)**

Decision-making on remuneration under the articles of association of most companies is left with the board itself. Articles can also provide that the directors shall be entitled to such remuneration as shall be voted to them in the general meeting, in which case there must be a resolution duly passed by the company (Companies Act 1985 Table A art. 82).

It is not normally sufficient to show the figure taken by directors in the accounts, and the acceptance by the company of the accounts will not in itself authorise remuneration which has not otherwise been authorised. Exceptionally, however, a resolution of the members approving the accounts may be a sufficient authorisation, if all the members are aware that, by being asked to approve the accounts, they are being asked also to approve the remuneration (*Felix Hadley & Co. Ltd. v. Hadley*, 1897, 77 L.T. 131).

Note: The relevant provisions deal in terms of directors, rather than the board of directors, as a general rule (see Q4).

#### **3.2 Are there provisions and/or practices as to the amount of the remuneration and its distribution (for example, as to whether distribution should be proportionate) among board members? What types of remuneration are allowed?**

Levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but companies should avoid paying more than is necessary for this purpose. A proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance (Combined Code B.1).

Many types of remuneration are permitted either for the executive or the non-executive directors (See Q4.3).

#### **3.3 Are personal loans to the company's directors and officers allowed?**

Detailed and complex rules are applied to the provision of personal loans to directors under Companies Act 1985 s330 in order to prevent abuse. In essence, companies cannot make a loan to a director, guarantee a loan to a director, provide security for such a loan, or enter into a credit transaction with a director. The prohibition extends to the company's holding company and covers any transactions of a similar nature with persons "connected" with the director. Some exemptions are provided (see also Q2.6).

Criminal sanctions follow a breach of s330 (Companies Act s342): a director of a relevant company who authorises or permits the company to enter into a prohibited transaction, knowing, or having reasonable cause to believe the company was breaching s330, is guilty of an offence. Under s341, the transaction is voidable by the company, unless restitution is impossible, a third party has acquired an interest, or the company has been indemnified. The director concerned and any director who authorised the transaction is liable to account to the



company for any gain made directly or indirectly from the transaction, and to indemnify the company for any loss or damage.

## 4. Executive Directors' Remuneration

**4.1 Who fixes the executive directors' remuneration? What are the relevant procedures? Are shareholders required to approve directors' remuneration, the remuneration policy, or the remuneration report (see question 2) on an annual or other basis? (In two-tier systems, please refer to the management board.)**

### (a) Procedures

#### (i) Company Law

As part of the company law rule that directors' may not make a profit from their activities as directors unless this has been expressly sanctioned by the company (the secret profit rule), the director of a company does not have a right to remuneration for services performed for the company, unless its payment has been provided for in the company's constitutional documents or approved by its members (*Hutton v West Cork Railway Co* (1883) 23 ChD 654).

In practice, however, it is standard for directors' remuneration to be covered in the articles of association. Where the statutory form is adopted (Table A), as noted in Q3 above, art. 82 provides that the directors are entitled to such remuneration as the company may, by ordinary resolution, determine.

Where the articles of association provide how remuneration is to be determined, the court will not make a determination of its own with respect to remuneration, by, for example, granting an "equitable allowance" (*Guinness plc v Saunders* [1990] 2 AC 663). As a result, where a company has adopted Table A, art. 82 and where the members do not determine remuneration, the directors are not entitled to receive any remuneration.

A company will usually also, however, adopt a provision in its articles providing that a director can be appointed to an office carrying particular executive responsibilities in excess of what would normally be expected of a director, and thus paid a salary in respect of those functions. The statutory form of articles of association, Table A, provides, for example, in art. 84, that: "the directors may appoint one or more of their number to the office of managing director or to any other executive office in the company...and they may remunerate any such director for his services as they see fit".

Therefore, where art. 82 and art. 84 are adopted by the company (as would be common as they are the statutory form), the shareholders in general meeting determine the fees of directors as director but, more importantly, the board of directors determines the remuneration of executive directors.

The directors may remunerate any executive director as they think fit. Normally such remuneration (whether by way of salary, commission, participation in profits, or partly in one way or partly in another) will be fixed in the service contract of the director in question. Where, however, the procedures set out in the articles is not followed, for example because the contract is entered into by a committee of the board in circumstances in which this power has not been delegated to the committee, the resulting contract will be void for want of authority and the normal equitable rule will re-assert itself (*Guinness plc v Saunders* [1990] 2 AC 663). Directors must, however tailor remuneration to the company's resources. Failure to do by a director can provide evidence of unfitness and be a ground for a disqualification order (*Secretary of State for Trade and Industry v Van Hengel* [1995] 1 BCLC 545).

#### (ii) Listing Rules/Combined Code

Companies should establish a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration (Combined Code B.2).

The remuneration committee should make recommendations to the board, within agreed terms of reference, on the company's framework of executive remuneration and its cost and should determine on behalf of the board of directors specific remuneration packages for each of the executive directors (Combined Code B.2.1). More generally, the chairman of the board should ensure that the company maintains contact as required with its principal shareholders about remuneration, in the same way as for other matters (Combined Code B.2.6)

#### **(b) Approval**

##### **(i) Companies Act 1985**

For financial years ending December 31 2002, under general company law, the Directors' Remuneration Report must be laid before the general meeting of the company before which the company's accounts for the relevant financial year are to be laid, for the approval by the general meeting via an ordinary resolution (Companies Act s241A (3)). As discussed in Q2.3, the Report sets out disclosure on individual directors' remuneration as well as on general remuneration policy and performance standards.

##### **(ii) Listing Rules/Combined Code**

Under the Combined Code, the board's annual remuneration report to shareholders need not be a standard item of agenda for Annual General Meetings. But the board should consider each year whether the circumstances are such that the Annual General Meeting should be invited to approve the policy set out in the report and should minute their conclusions (Combined Code B.3.5).

Note : This recommendation should now be read in light of the new 2002 company law requirements with respect to the Remuneration Report.

Shareholders should be invited specifically, and in some cases are required (see Q4.4), to approve all new long term incentive schemes save in the circumstances permitted by the Listing Rules (Combined Code B.3.4; Listing Rules 13.13).

#### **4.2 Is the board required, or recommended as best practice, to create a remuneration committee?**

Yes. The board of directors should set up a remuneration committee to avoid potential conflicts of interest. The committee should operate within agreed terms of reference and make recommendations to the board on the company's framework of executive remuneration (Combined Code B.2.1).

#### **If yes, please specify:**

##### **(i) the committee's composition (if independent directors should be appointed to this committee, please give the relevant definition and indicate whether any special procedures apply to the appointment of independent non-executive directors)**

Remuneration committees should consist exclusively of non-executive directors who are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement (Combined B.2.2).

##### **(ii) the committee's competences and which company body it reports to**

See Q4.2(a).

**(iii) how the committee operates**

The remuneration committee should consult the chairman and/or managing director about its proposal relating to the remuneration of other executive directors and have access to professional advice inside and outside the company (Combined Code B.2.5).

With regard to remuneration policy, the remuneration committee should provide the packages needed to attract, retain and motivate executive directors without paying more than is necessary for this purpose, and should be aware what comparable companies are paying and take account of relative performance (Combined Code B.1.1). Remuneration committees should judge where to position their company relative to other companies. They should be aware what comparable companies are paying and should take account of relative performance. But they should use such comparisons with caution, in view of the risk that they can result in an upward ratchet of remuneration levels with no corresponding improvement in performance (Combined Code, B.1.2). Remuneration committees should be sensitive to the wider scene, including pay and performance conditions elsewhere in the group, especially when determining annual salary increases (Combined Code B.1.3).

The performance-related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give these directors keen incentives to perform at the highest levels (Combined Code B.1.4).

**4.3 Which types of remuneration are permitted?**

Many types of remuneration are permitted, including benefits in kind, annual and deferred bonuses, share options, stock grants and long term incentive schemes, termination payments, and defined benefit schemes (Companies Act 1985 passim; Listing Rules 12.43A, 13.13; Combined Code passim).

For companies who adopted Articles of Association in the statutory form, Table A, Art 83 expressly authorises the payment of all travelling, accommodation and other expenses incurred by directors in connection with the pursuit of their duties.

**In answering, please consider each of the following:**

**(a) bonuses**

Remuneration committees should consider whether the directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching, and designed to enhance the business. Upper limits should always be considered and bonuses should not be pensionable (Combined Code Schedule A 1, 7).

**(b) stock options, including discounted stock options**

Remuneration committees should consider whether the directors should be eligible for benefits under long-term incentive schemes. Traditional share option schemes should be weighed against other kinds of long-term incentive scheme. In normal circumstances, shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in under three years. Directors should be encouraged to hold their shares for a further period after vesting or exercise, subject to

the need to finance any costs of acquisition and associated tax liability (Combined Code Schedule A 2).

Payouts or grants under all incentive schemes, including new grants under existing share option schemes, should be subject to challenging performance criteria reflecting the company's objectives (Combined Code Schedule A 4).

Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block (Combined Code Schedule A 3).

Executive share options should not be offered at a discount save as permitted by the Listing Rules (see 4.4) (Combined Code B.1.5; Listing Rules 13.30, 13.31).

**(c) stock grants**

See Q4.3(b).

**(d) profit sharing**

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**(e) benefits in kind**

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**4.4 Are there specific rules, including shareholder approval requirements, as to these different types of remuneration?**

The Listing Rules govern this area.

With regard to employees' share schemes and long-term incentive schemes, the Listing Rules provide that the following schemes must be approved by an ordinary resolution of the shareholders of the company in general meeting prior to their adoption: (i) an employees' share scheme if the scheme involves or may involve the issue of new shares; and (ii) a long-term incentive scheme in which one or more directors of the issuer is eligible to participate (Listing Rule 13.13; see also Q2.6).

These requirements do not apply to the following long-term incentive schemes: (i) an arrangement under which participation is offered on similar terms to all or substantially all employees of the issuer or any of its subsidiary undertakings whose employees are eligible to participate in the arrangement (provided that all or substantially all employees are not directors of the issuer); and (ii) an arrangement in which the only participant is a director of the issuer (or an individual whose appointment as a director of the issuer is in contemplation) and the arrangement is established specifically to facilitate, in unusual circumstances, the recruitment or retention of the relevant individual.

Where the above two circumstances apply the following information must be disclosed in the first annual report published by the issuer following the date on which the relevant individual becomes eligible to participate in the arrangement: the information required under Listing Rule 13.14 (a)-(d)(see below); the name of the sole participant; the date on which the participant first became eligible to participate in the arrangement; explanation of why the circumstances in which the arrangement was established were unusual; the conditions to be satisfied under the terms of the arrangement; and the maximum award(s) under the terms of the arrangement or, if there is no maximum, the basis on which awards will be determined (Listing Rules 13.13A).

With respect to the schemes specified in Listing Rule 13.13, a number of disclosure rules apply under Listing Rule 13.14. The circular to shareholders in connection with the approval of an employees' share scheme or a long-term incentive scheme must include either the full text of

the scheme or a description of its principal terms (13.14(a)); include, where directors of the company are trustees of the scheme, or have a direct or indirect interest in the trustees, details of such trusteeship or interest (13.14 (b)); state that the provisions (if any) relating to: the persons to whom, or for whom, securities, cash or other benefits are provided under the scheme (the “participants”); limitations on the number or amount of the securities, cash or other benefits subject to the scheme; the maximum entitlement for any one participant; the basis for determining a participant’s entitlement to, and the terms of, securities, cash or other benefit to be provided and for the adjustment thereof (if any) in the event of a capitalisation issue, rights issue or open offer, sub-division or consolidation of shares or reduction of capital or any other variation of capital: cannot be altered to the advantage of participants without the prior approval of shareholders in general meeting (except for minor amendments to benefit the administration of the scheme, to take account of a change in legislation or to obtain or maintain favourable tax, exchange control or regulatory treatment for participants in the scheme or for the company operating the scheme or for members of its group) (13.14(c)); state whether benefits under the scheme will be pensionable and, if so, the reasons for this (13.14(d)); if the scheme is not circulated to shareholders, include a statement that will be available for inspection: from the date of the dispatch of the circular until the close of the relevant general meeting, at a place in or near the City of London or such other place as the FSA may determine; and at the place of the general meeting for at least 15 minutes prior to and during the meeting (13.14(e)); and comply with the relevant requirements of the contents of all circulars (13.14(f)).

The resolution contained in the notice of meeting accompanying the circular must refer either to the scheme itself (if circulated to shareholders) or to the summary of its principal terms included in the circular (Listing Rules 13.15).

A resolution approving the adoption of an employees’ share scheme or long-term incentive scheme may authorise the directors to establish further schemes based on any scheme which has previously been approved by shareholders but modified to take account of local tax, exchange control or securities laws in overseas territories, provided that any shares made available under such further schemes are treated as counting against any limits on individual or overall participation in the main scheme (Listing Rules 13.16).

A circular to shareholders in connection with any proposed amendments to an employees’ share scheme or a long-term incentive scheme (if the scheme would require shareholder approval) must: include an explanation of the effect of the proposed amendments; include the full terms of the proposed amendments, or a statement that the full text of the scheme as amended will be available for inspection; and comply with the relevant requirements of the contents of all circulars (Listing Rules 13.17).

With regard to discounted option arrangements, a listed company may not, without the prior approval by an ordinary resolution of the shareholders of the listed company in general meeting, grant to a director or employee of the issuer or of any subsidiary undertaking of the issuer an option to subscribe, warrant to subscribe or other similar right to subscribe for shares in the capital of the issuer or any of its subsidiary undertakings, if the price per share payable on the exercise of such an option, warrant or other similar right to subscribe is less than whichever of the following is used to calculate the exercise price: the market value of the share on the date when the exercise price is determined; the market value of the share on the business day before such date; or the average of the market values for a number of dealing days within a period not exceeding 30 days immediately preceding such date (Listing Rules 13.30).

These provisions do not apply to the grant of an option to subscribe, warrant to subscribe or other similar right to subscribe for shares in the capital of the issuer or any of its subsidiary undertakings: under an employees' share scheme pursuant to the terms of which participation is offered on similar terms to all or substantially all employees of the issuer or any of its subsidiary undertakings whose employees are entitled to participate in the scheme; or following a take-over or reconstruction, in replacement for and on comparable terms with options to subscribe, warrants to subscribe or other similar rights to subscribe held immediately prior to the take-over or reconstruction in respect of shares in either a company of which the issuer thereby obtains control or in any of that company's subsidiary undertakings (Listing Rules 13.31).

Where shareholders' approval is required, the following information must be circulated to shareholders: details of the persons to whom the options, warrants or rights are to be granted; a summary of the principal terms of the options, warrants or rights; and details of the relevant requirements of the contents of all circulars (Listing Rules 13.32).

#### **4.5 Are there any restrictions on how payments are made?**

It is not lawful for a company to pay a director remuneration free of income tax, or otherwise calculated by reference to or varying with the amount of his income tax, or to or with any rate of income tax (Companies Act 1985 s 311). Companies are not, therefore, permitted to vary a director's remuneration to track changes in income tax levels.

#### **4.6 Are there any specific requirements for termination payments made on loss of office, whether through dismissal, retirement, on a takeover, or otherwise?**

##### **(a) Companies Act 1985**

Where a company has adopted articles of association in the form of Table A (the statutory model) the directors may provide benefits, whether by the payment of gratuities or pensions or by insurance or otherwise, for any director who has held but no longer holds any executive office or employment with the company and may contribute to any fund and pay premiums for the purchase or provision of any such benefit (art 87). This may be done without the approval of the shareholders in the general meeting, in spite of the potential conflicts of interest that may arise in some circumstances (for example, when the question of "golden parachutes" for directors is before the board).

The equitable principle of shareholder approval is, however, partly restored by the Companies Act which provides that it is not lawful for a company to make to a director of the company any payment by way of compensation for loss of office, or as consideration for or in connection with his retirement from office, without particulars of the proposed payment (including its amount) being disclosed to members of the company and the proposal being approved by the company (s312). A similar provision applies under s313(1) to payments made on loss of office where the company is wound up or sold off: shareholder approval is required for any payment made to a director in connection with the transfer of the whole or any part of the undertaking of a company by way of compensation for loss of office or as consideration or in connection with his retirement from office. Takeovers are addressed by ss314 and 315 which provide that shareholder approval is required for payments made as compensation/consideration in connection with a "transfer" of all or any of the company's shares, as defined in section 314(1). Under s314(2), the director is subject to a duty to take all reasonable steps to secure that information relating to the payment is included with any notice of the offer sent to shareholders. The ss312-315 requirements do not apply, however, to any bona fide payments by way of damages for breach of contract or by way of pension for past services (s316(3)) As s312 applies only to voluntary payments, controversially, the section does not apply to payments which the company is contractually bound to make. Thus, in *Taupo*

*Totara Timber Co. Ltd v. Rowe*, [1987] AC 537, the contract of employment of a managing director which allowed him to terminate his contract in the event of a takeover of the company and to claim a lump sum payment was found to escape the section's protection of shareholder approval.

Section 303 of the Companies Act governs the removal of directors by shareholders. Under section 303(5), the shareholders' power of removal cannot deprive a director of a claim for damages in respect of the termination. The terms of the director's service contract may provide a basis for such a claim. These terms are, however, usually set by the directors (Table A, art 84) who can, as a result, entrench their position and make their removal potentially financially onerous for the company. The five year limit on the term of directors' service contracts (without shareholder approval) (see Q4.7), acts as a restriction, however, on the quantum of damages payable.

Detailed disclosure with respect to termination payments is now required in the Directors' Remuneration Report. See Q 2.1 and Q2.3 above.

### **(b) Listing Rules/Combined Code**

Termination payments, as an element of directors' remuneration, are to be disclosed in the annual report and accounts (see Q2.1 and Q2.3). In particular, disclosure must be made in respect of each director by name of any compensation for loss of office, payment for breach of contract, or other termination payment (Q2.3).

Under the Combined Code, remuneration committees should consider what compensation commitments (including pension contributions) their directors' contracts of service, if any, would entail in the event of early termination. They should in particular consider the advantages of providing explicitly in the initial contract for such compensation commitments except in the case of removal for misconduct (B.1.9).

Where the initial contract does not explicitly provide for compensation commitments, remuneration committees should, within legal constraints, tailor their approach in individual early termination cases to the wide variety of circumstances. The broad aim should be to avoid rewarding poor performance while dealing fairly with cases where departure is not due to poor performance and to take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss. (Combined Code B.1.10).

Remuneration committees should consider the pension consequences and associated costs to the company of basic salary increases and other changes in remuneration, especially for directors close to retirement. (Combined Code Schedule A 6), while in general, neither annual bonuses nor benefits in kind should be pensionable.

### **(c) Listing Particulars/Prospectuses**

Disclosure as to termination payments is required in listing particulars and prospectuses. See Q2.6.

The treatment of termination payments is currently under review: see UK Q1.3(b) above.

## **4.7 Are there any specific requirements concerning directors' service contracts with respect to, for example, their duration and disclosure?**

### **(a) Companies Act 1985**

Directors' contracts of employment of more than five years which contain a term providing that during its term the contract cannot be terminated by the company or can only be terminated in specified circumstances, must receive prior approval from the general meeting via a resolution. (Companies Act s319). Approval must be given on a case-by-case basis: the board may not be given a general consent from the shareholders to appoint directors beyond five years. Approval must be received before the contract is made (*Atlas Wright (Europe) Ltd v*

*Wright* [1999] BCC 163). If approval is sought, a memorandum setting out the proposed agreement must be made available for inspection by company members not less than 15 days before the meeting and at the meeting itself (s319(5)). Any such term is void unless approval is received and the appointment can then be terminated by the company giving reasonable notice (s319(6)).

Service contracts (i.e., contracts covering services as an employee, such as a managing director, but not contracts for services, such as contracts covering service as a director) for each director must be made available for inspection by the members of the company (s318) in an “appropriate place”, such as the company’s registered office, the place where the register of members’ is kept, or its principal place of business (s318(3)). All copies or memoranda must be kept in the same place and the company must notify the Registrar of Companies where the contracts are kept (s318(4)). Where the contract is not in writing, a memorandum of its terms must be made available. The copies and memorandum must be open to inspection to members of the company without charge (s318(7)). This right of inspection, which is limited to members, is not, however, widely exercised.

Disclosure with respect to service contracts is required in the Directors’ Remuneration Report (see Q 2.3).

### **(b) Listing Rules/Combined Code**

The Listing Rules impose additional disclosure requirements for listed companies. Listing Rule 16.9 requires that: copies of each director’s service contract be made available for inspection by any person (i) at the registered office of the company, or in the case of an overseas company, at the offices of any paying agent in the United Kingdom during normal business hours on each business day; and (ii) at the place of the annual general meeting for at least 15 minutes prior to and during the meeting.

Under Listing Rule 16.10, where one directors’ service contract covers both directors and executive officers, the company may make available for inspection a memorandum of the terms of the contract which relate to the directors only.

Listing Rule 16.11 requires that the directors’ service contracts available for inspection must disclose or have attached to them the following information: (i) the name of the employing company; (ii) the date of the contract, the unexpired term and details of any notice periods; (iii) full particulars of the director’s remuneration including salary and other benefits; (iv) any commission or profit sharing arrangements; (v) any provision for compensation payable upon early termination of the contract; and (vi) details of any other arrangements which are necessary to enable investors to estimate the possible liability of the company upon early termination of the contract. This last requirement therefore extends the Companies Act disclosure requirement from service contracts to “any other arrangements”.

Specific reference is made in the Listing Rules to disclosure of notice periods. Under 12.43A (c)(vi) and (vii) the annual reports and accounts must disclose: details of any directors’ service contract with a notice period in excess of one year or with provisions for pre-determined compensation on termination which exceeds one year’s salary and benefits in kind, giving the reasons for such notice period; and the unexpired term of any directors’ service contract of a director proposed for election or re-election at the forthcoming annual general meeting and, if any director proposed for election or re-election does not have a directors’ service contract, a statement to that effect [Note: these rules will change to reflect the 2002 revisions with respect to the Directors’ Remuneration Report.]. This provision is reflected in the Combined Code which states that any service contracts which provide for, or imply, notice periods in excess of one year (or any provisions for predetermined compensation on termination which exceed one year’s salary and benefits) should be disclosed and the reasons for the longer notice periods explained (Combined Code Schedule B 7). The Combined Code also states, however, that there is a strong case for setting notice or contract periods at, or reducing them to, one year or less. Boards should set this as an objective; but they should recognise that it may not be possible to



achieve it immediately (Combined Code B.1.7). It goes on to state that if it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce after the initial period (Combined Code B.1.8).

**(c) Listing Particulars/Prospectuses**

Disclosure as to service contracts is required in listing particulars and prospectuses. See Q2.6.

## **5. Non-executive Directors' Remuneration**

**5.1 Are non-executive directors separately paid for their participation in committees of the board of directors? Do any restrictions apply to the payment of non-executive directors' *via* stock options?**

The board itself or, where required by the articles of association, the shareholders should determine the remuneration of the non-executive directors, including members of the remuneration committee, within the limits set in the articles of association. Where permitted by the articles, the board may however delegate this responsibility to a small sub-committee, which might include the managing director (Combined Code B.2.4).

**5.2 May a company make payments to non-executive directors, additional to their directors' fees, for services, such as legal or brokerage services, outside the usual scope of directors' duties?**

The articles usually authorise the payment by the directors to one of their number of extra remuneration for special services outside the scope of the usual duties of a director. For companies which adopted the statutory form, Table, A art 84, for example, provides that the directors may enter into an agreement or arrangement with any director for that director's employment by the company and that the directors may enter into an agreement/arrangement with any director for the supply by that director of services outside the scope of the ordinary duties of a director. The directors are to set the terms of any such agreement and remuneration may be set as the directors think fit.