

Confidential

NOMINET BOARD

REVIEW 2008/9

**Comparison with the
2006 Combined Code**

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NOMINET BOARD REVIEW

NOMINET AND THE 2006 COMBINED CODE OF CORPORATE GOVERNANCE:

An independent assessment by Professor Bob Garratt of Nominet's Constitution and Board in comparison with the UK's 2006 Combined Code.

Finalised in April 2009 after changes in the Board composition.

Context

The BERR letter of 15 October 2008 stresses Nominet's role as a self-regulating national asset. Whilst BERR thought that the dispute resolution process is a good example of self-regulation, they did ask that interests outside the domain name sector are properly addressed. Mr David Hendon, Director of Business Relations 2, stated "*I was left with unresolved concerns about how Nominet's constitution and structure addresses its responsibility to stakeholders other than its Membership and I suggest that the best way to address those concerns might be for me to write to focus these concerns into some specific questions. This would give you the opportunity to expand on the points made at our meeting so that we may better understand the issues. With that greater understanding, we will be able to advise Ministers if there is a problem and what solutions are available.*"

The questions are as follows:

How do Nominet's constitution and Board structure follow accepted best practice in terms of corporate governance as set out in the combined code?

How effectively does the company ensure that the directors of the company reflect the wider stakeholder issues?

In particular, how does Nominet ensure the continued development and evolution of industry self-regulation in order to protect wider stakeholder interests?

What arguments would you employ to convince my Ministers that the present relationship between Government and the company is appropriate in ensuring that public policy objectives in relation to the management of the domain name system and the standing of the UK in the internet community are understood and taken into account?

Are there any actions that either the company or Government –individually or together – might take in the short-term to address any of the concerns identified in relation to the above questions?

It would be useful if, in answering these questions, you could draw on independent expert advice to ensure effective benchmarking against good corporate governance standards adopted by other companies operating key national infrastructure and international best practice”.

A Comparative Review of Nominet’s Corporate Governance with the 2006 Combined Code

This Review is a personal response from Professor Bob Garratt, Visiting Professor in Corporate Governance at Cass Business School, London, and Professor Extraordinaire and Chairman of the Unit for Corporate Governance in Africa, University of Stellenbosch, South Africa.

In relation to the BERR letter and because I am not qualified to do so, I have seen it as beyond my remit to comment on both industry self-regulation, the management of the present domain name system and its relationship with Government but I note that these will be covered amongst others in the newly commissioned Mutuo Review on which I am happy to make some brief comments on its publication.

A Caveat

These personal comments are based on comparing Nominet’s governance processes and structure with the UK’s 2006 Combined Code of Corporate Governance. The Combined Code refers only to UK Listed Companies. As Nominet is a Company Limited By Guarantee, the Code does not apply as a mandatory, disclosure requirement. Nominet has no share capital, or indeed shares. The ‘guarantee’ is of the legal ‘members’ (not the membership) and it has ‘not for profit’ status. The legal entity formed at the creation of Nominet was designed to ensure that no member had a financial investment in the organisation. This altruistic concept means that whilst it can create surpluses it cannot distribute them to its membership but must use them to pursue its Objectives as spelled out in its Constitution.

However, the Combined Code, especially the Main Principles, is seen nationally and internationally as a firm basis for the effective governance of any organisation, public or private. It is in this context that I have conducted this Review. My sources have been the interviews of the Board during the Board Self-Evaluation process.

Nominet and Corporate Governance

Nominet's Board agreed to try apply them where appropriate and practical as reported in the Annual report of 2003 (pps 12–13) states:

During the year, the Board reviewed the company's compliance with the Higgs and Smith reports on Corporate Governance (much of which has now been incorporated into the Combined Code). The reports are aimed primarily at listed companies so Nominet is under no obligation to comply with their recommendations, however the Board considered it good practice to review the recommendations and apply them where appropriate and practical. As a result, two new Board committees were introduced covering remuneration and company audit.

It must be noted that since October 2007 Nominet must comply with the 2006 Companies Act, and its seven non-exhaustive duties of directors. These include the Duties of Care, Skill and Diligence and a statutory prohibition on director's conflicts of interest. However, Nominet's Articles are in contradiction here as whilst they require such conflicts to be notified they do not allow the Board to approve any conflict. I have kept these firmly in mind whilst making this comparison.

THE 2006 COMBINED CODE OF CORPORATE GOVERNANCE

(Comments marked 'BG:' are Professor Garratt's personal responses to the comparison with the Combined Code)

A DIRECTORS

A.1 The Board

Main principle

Every company should be headed by an effective Board, which is collectively responsible for the success of the company.

BG: Although this principle was accepted by all respondents to the Board's Self-evaluation there is a strong feeling both within the Board, and reportedly in the wider membership and in BERR, that the present Board is now in circumstances where it has not been able to fulfil its role effectively. Deep divisions within the Board between two elected directors and the rest of the Board have made both the development of individual and corporate duties of directoral Skill, Care and Diligence, avoidance of conflicts of interest and that of collective responsibility difficult to deliver. This Review deals with these issues in depth and suggest ways in which they can be rectified.

It is noted that during my Review one of the directors has resigned, another had an application for an injunction to restrain alleged breaches of director's duties and conflicts of interest served (who has resigned subsequent to my report), and that a new director has just been co-opted. I am hopeful that these actions will stabilise the Nominet Board and, if it addresses the reforms to its Constitution suggested at the end of this Review, will allow it to regain its proper roles.

Supporting Principles

The Board's role is to provide entrepreneurial leadership within a framework of prudent and effective controls enabling risks to be assessed and managed; setting strategic direction and ensuring the necessary financial and human resources are in place for the company to meet its objectives and to review management performance.

The Board should set the company's values and standards and ensure that its obligations to its stakeholders and others are understood and met.

BG: It was noted by all of the respondents to the Board Review that the recent confusing and sometimes bitter infighting on the Board had created three negative effects. First, that considerable energy had been diverted from the key role of any Board – driving the enterprise forward whilst keeping it under prudent control. Second, given the turbulence caused by the continuing Credit Crunch and the likely effects on Nominet's markets, this diversion of energy has left the Board little time to respond quickly with strategic thinking responses to that turbulence and has left a lot of the prudent control processes entirely to the executives, rather than allowing it to develop the Board's role of challenging constructively the

executives. The threats and actual litigation around the boardroom table has exacerbated these problems.

Third, although Nominet's financial base looks strong in the short-term and has been externally audited as such, the recent period without a permanent Director of Finance (FD), and given both the period needed to induct and bring the new FD to full Board inclusion, and the relative inexperience of the Audit Committee, Nominet must keep close scrutiny of its finances to ensure no longer-term financial risk.

March 2009 Update:

I note that the newly appointed NED has an Audit background and is now a member of the Audit Committee. I find this reassuring.

As an overall personal comment, I note from the respondents that the public airing of the Board dissension, and attempts by some Board members to obtain information directly from the staff without going through due process via the Chairman, has unsettled the staff. Given also the short absence of the Chief Executive, the recent past has had some destabilising effect on staff confidence. Without having a strong HR function linked directly to the Board, Nominet is in danger of losing competent staff in the medium-term unless this position is rectified.

All directors must take decisions objectively in the long-term interests of the company.

BG: Two issues were mentioned strongly by respondents to the Board Review. First, that there is a lack of sufficient Induction for directors to the Nominet Board in terms of both depth and continuity, especially in building the competences for the Duties of Skill, Care and Diligence which form also the basis of much of the new 2006 Companies Act. This is reported as a particular problem when members are appointed as a director. This has created confusion over the roles and tasks of directors and the Board which has increased the Board conflicts. The key legally-based corporate governance concepts of the Board's *Collective* Responsibility, and especially of the Primary Loyalty of each director being to the company as a separate legal personality (to avoid conflicts of interest) have not been developed well around the boardroom table and consequent frustration has flowed.

As a personal comment, I have found a judgement of Lord Denning in 1963 helpful in explaining the primary loyalty issue and so, as it is used in many business school programmes in the UK and Commonwealth, I quote it here:

Or take a nominee director, that is, a director of a company who is nominated by a large shareholder to represent his interests. There is nothing wrong in that. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgement in the interest of the company which he serves. But if he is put on terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful.

(Boulting and the Association of Cinematograph Television and Allied Technicians
1963 2 QB 606)

BG The Nominet Board has industry and Internet community representation on it which is a major strength. However, my concern is its skills gap due to the relative directoral experience of some of the members. The Board issues have then become more complicated as a mixture of dissension, inexperience of some Board members and the lack of induction and personal directoral competence-building has led to an over-reliance by the Board on the Executives. The roles of Chairman/Managing Director (despite the present incumbent's actions to maintain a Non-executive role), the Chief Executive and the Director of Legal and Policy have become stronger in relation to the NEDs generally. This is an understandable reaction in troubled times and the executives have done their best to keep Nominet not just afloat but seen to be operating well in the public's mind, nationally and internationally and financially strong. But it has taken significant direction-giving power out of the Board's hands and this needs to be rectified.

I shall return to the structural and role issues of the Non-Executive Directors (NEDs) and Executive Directors later in pages 14–21.

As part of their role as members of a unitary Board, NEDs should constructively challenge and help proposals on strategy. NEDS should scrutinise the performance of management in meeting agreed goals, objectives and monitor the reporting of performance.

BG: Nominet does not have a mature Board in directoral experience terms, although as previously mentioned in industry/technical experience it is fine. In particular, the majority of its NEDs have little previous Board experience. Despite the goodwill of the majority of directors, the lack of rigorous competence-building has not allowed the development of a truly cohesive Board i.e. one that acknowledges its differences and is yet able to generate a significant majority to drive Nominet forward with the agreement of any dissenting directors. Currently it is reported through the Board Self-evaluation that the majority of the NEDS see that the key Board tasks of 'constructive challenge of strategy' and 'scrutinising the performance of management' are not being performed fully.

March 2009 update:

I note that steps are now under way to rectify this and that recent changes in Board composition and structure should help greatly.

In a mature Board – where personal differences are acknowledged but submerged ultimately for the good of the company – it is quite normal to have heated debates. But once a majority is in agreement on an issue then the collective will rules. Proper minutes should be kept of any such decisions and of any dissent and they have been. However, dissenters who continue against the majority view and are unable to influence this must consider their position ultimately and resign, writing to the Chairman with their reasons for resignation. They are at liberty to put themselves up for re-election as directors and are subject to the will of the electors at an AGM or EGM. Such processes have not happened fully at Nominet recently and the later tendency towards litigation and the consequent involvement in the public domain has not helped Nominet's image and seems to be the result of deep frustration on both sides at the failure to resolve deeply-held views.

On a mature Board, scrutiny of the management on a regular and rigorous basis should focus on agreed performance indicators and not permit the ‘micro-managing’ of the executives from the boardroom table, of which there have been signs in the recent past.

Ensuring the integrity of the financial information by the directors is paramount and I shall deal with this under the section on the Audit Committee in pages 48-52. Similarly, I shall deal with the issues of director appointment, induction, development, evaluation, succession planning and remuneration later in pages 28-33.

Code provision

A.1.1 The Board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the Board operates, including a high level statement of which types of decisions are to be taken by the Board and which are to be delegated to management.

BG: The Board is compliant here and has a board paper ‘Matters Reserved for the Board’ which covers this section.

A1.2 The Annual report should identify the Chairman, the Deputy Chairman (where there is one), the Chief Executive, the senior independent director and the Chairmen and members of the Nomination, Audit and Remuneration Committees. It should also set out the number of meetings of the Board and those Committees and individual attendance by directors.

BG: Nominet is compliant here, although it does not have a senior independent director.

March 2009 update:

The recent appointment of an independent NED should help here and the earlier appointment of a Deputy Chairman is helpful.

A.1.3 The Chairman should hold meetings with the NEDs without the executives present. Led by the senior independent director the NEDS should meet without the Chairman present at least annually to appraise the Chairman’s performance (as described in A.6.1) and on such occasions as are deemed appropriate.

BG: Nominet cannot be compliant here because of the roles set out in its Constitution. It is technically impossible for the Chairman (because of his dual roles) to hold meetings with the NEDs with no EDs present despite the Chairman’s wish to be seen only as an NED. Neither does Nominet have a Senior Independent Director.

A.1.4 Where directors have concerns, which cannot be resolved about the running of the company, or a proposed action, they should ensure that their concerns are recorded in the Board minutes. On resignation, an NED should provide a written statement to the Chairman, for circulation to the Board, if they have any such concerns.

BG: Nominet is compliant here and Messrs. Hanton and Davies have made their statements to a much wider public.

A.1.5 *The company should arrange appropriate insurance cover in respect of legal action against its directors.*

BG: There is some confusion reported in the Board Self-evaluation as to the present position here. There is currently contention over the current appropriate insurance cover for directors particularly in relation to directors seeking independent legal advice outside the company. It is unclear as to the range of such cover. This issue is before the Board and inputs have been made by Nominet's brokers, Marsh, and by Michael Todd QC.

A.2 Chairman and Chief Executive Officer

Main principle

There shall be a clear division of responsibilities at the head of the company between the running of the Board and the executive responsibility of running the company's business. No one individual shall have unfettered powers of decision.

Supporting principle

The Chairman is responsible for the leadership of the Board, ensuring its effectiveness on all aspects of its role and setting its agenda. The Chairman is also responsible for ensuring that the directors receive accurate, timely and clear information. The Chairman should ensure effective communication with the shareholders.

BG: Here lays a fundamental flaw in the current governance of Nominet. Its Constitution is designed to combine the roles of the Chairman and Managing Director (Constitution Article 26) and is, therefore, non-compliant with the Combined Code and with current views of good practice in corporate governance. It means that neither role can be exercised fully and effectively and is in corporate governance circles seen to be bad practice. It is suggested strongly that the membership must reconsider this aspect of their constitution if they are to be seen to be following good corporate governance practice and to have credibility in the wider community.

The Chairman should also facilitate the effective contributions of the NEDs in particular and ensure constructive relations between the EDs and NEDs.

BG: Given the recent tensions within the Board this area needs careful rebuilding of trust both between the NEDs and EDs, and in the integrity of the information systems used by the Board. Ways of doing this are dealt with in pages 28–33 on Board Induction and Development. The emphasis is less here on non-compliance, rather on the building of emotional intelligence within the Board.

A.2.1 *The roles of the Chairman and Chief Executive should not be exercised by the same individual. The division of responsibilities between the Chairman and the Chief Executive should be clearly established, set out in writing and agreed by the Board.*

BG: See my comments above about Nominet's non-compliance. It should be noted that a 'Managing Director' is by definition a member of the Board of directors.

A 'Chief Executive' is not unless elected also to membership of the Board as a statutory director. The Nominet CEO's service agreement requires that she acts as a director of the company. The Board has attempted to follow good corporate governance practice but this always has the potential to put it into conflict with Nominet's constitution.

A.2.2 The Chairman should on appointment meet the independent criteria set out in A.3.1 below. A chief executive should not go on to be Chairman of the same company. If exceptionally a Board decides that a Chief Executive should become Chairman, the Board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.

BG: As the Board is currently non-compliant because of its constitution this provision does not apply.

A 3 Board Balance and Independence

Main principle

The Board should include a balance of EDs and NEDs (and in particular independent NEDs) such that no individual or small group of individuals can dominate the Board's decision-making.

BG: This is another crucial issue at the heart of Nominet's corporate governance issues due to its dysfunctional constitution. Although in the present constitution (Article 26) there is a small majority of NEDs elected from the membership, in practice this is countered by three factors. First, the skills gap of the NEDs as professional Board members, with the exception of the current Chairman. This means that their oversight duties are hard to fulfil, yet they are personally and legally bound to be seen to exercise their duties of Skill, Care and Diligence. Despite the Nominet voting paper setting out the director's duties and liabilities, the present system of voting by the membership for these directoral positions does not seem to take these duties, nor the need for directoral experience, into serious account in practice. Nominet has put itself into an exposed position in corporate governance terms. The personal position of each director seems potentially exposed both in corporate terms and in possible claims on their personal wealth if they could be shown to have not acted carefully, skilfully and diligently. Given the skills gap around the boardroom table this will need rapid and rigorous development.

Second, there is, therefore, a tendency to place over-reliance on the EDs both for information and for direction. In turn this reduces the capacity for the NEDs to fulfil their role of constructively challenging the EDs, especially over the integrity of their information and the basis of their strategies.

The combined Chairman and Managing Director role does nothing to help here as in 'normal' organisations the Chairman is *the boss of the Board of directors* only (not of Nominet) and the Chief Executive is *the boss of the day-to-day operations of Nominet*. The Chairman is meant to have independent oversight of the Nominet operations but, despite his best efforts to play only the NED role, he cannot fulfil fully that role as he is conflicted by his constitutional executive role.

Third, the present system of the election of members does not allow any NED to be ‘independent’ under the Combined Code. This may not be an issue if such election is purely a matter for the membership alone. However, in terms of the wider community, (‘the public good’) the directors, through membership election, have powers beyond merely club rules. They maintain a national asset in that the Registry is part of the national information framework; and the members set the tariffs. It seems to me that this latter brings Nominet’s corporate governance and economic regulator issues into the public domain and subject, therefore, to public scrutiny. I suggest strongly that the membership considers how to incorporate these public oversight issues into their future corporate governance before it is done for them. One possibility is to have the membership agree to appoint at least two truly independent directors on to the Board.

Supporting Principles

The Board should not be so large as to be unwieldy. The Board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the Board’s composition can be managed without undue disruption.

BG: Many studies of effective work groups, including Boards of directors, have shown over some sixty years that a key concept in group size is that of ‘sufficient variety’. Groups smaller than four people have insufficient variety in them to problem-solve successfully over time. Groups larger than twelve people become difficult to manage as they spend inappropriate amounts of time and energy trying to organise themselves and resolve conflicts. On this basis the Nominet Board is at the very limit of minimum reasonable size and needs strengthening in directoral experience especially in terms of Strategy, Finance Human Resources and Operational oversight. I note that previous efforts to increase the size of the Board have been rejected by the membership. However, this leaves Nominet in a dangerous position in relation to accepted corporate governance practice. I shall comment more at the end of this section.

To ensure that power and information are not concentrated in one or two individuals, there should be a strong presence on the Board of both EDs and NEDs.

BG: See above

The value of ensuring that Committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of Committees.

BG: See later comments of director induction, competence-building and Committee membership (pages 28–33).

No one other than the Committee Chairman and members is entitled to be present at a meeting of the Nomination, Audit or Remuneration Committee, but others may attend at the invitation of the Committee.

BG: Yes, and see my later comments on Committees.

Code provisions

A.3.1 *The Board should identify in the annual report each NED it considers independent. The Board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The Board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to the determination, including if the director:*

- *Has been an employee of the company or group within the last five years;*
- *Has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;*
- *Has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;*
- *Has close family ties with any of the company's advisers, directors or senior employees;*
- *Holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;*
- *Represents a significant shareholder; or*
- *Has served on the Board for more than nine years from the date of their first election.*

BG: This shows a major area of non-compliance for the Board in relation to the Combined Code. It raises also a much deeper problem for Nominet as a member-based organisation which I have mentioned briefly above. Two issues strike me clearly. Can any member elected to the Board ever be considered truly 'independent'? Because they have a direct economic interest in the decisions of the Board, in the setting of their membership fees and in the setting of the Registry tariff, I feel that they cannot; which makes their directoral position untenable under the terms of the Combined Code. For example, they would not be able to demonstrate their legal duty of primary loyalty to the company. They would have to declare their conflicted interest in any issue of pricing and so rule out their ability to vote on a recommendation (under Article 19a) to the membership on such an issue. With no elected NED able to vote, the EDs would rule. This situation is dangerous and needs rapid rectification, especially as the current weighted voting policy seems to concentrate the voting power into the hands of the 25 biggest customers. This is why I suggest exploring the idea of having at least two truly independent directors appointed to the Board.

Second, the very fact that the membership, through the Board, sets its own fees looks astonishing in what, I assume, is a national economic regulator. By the membership setting its own tariff without an external regulator, Nominet seems to have exposed itself to public and, therefore, Governmental concern. With the Government considering the whole issue of the future roles of all economic regulators, with the forthcoming Communications Act in the area of political debate, with Ofcom extending its role in the background, and with potential interest from the Monopolies Commission and Office for Fair Trading, Nominet has set itself up for much greater scrutiny and likely public criticism. Indeed, I am concerned that, at the very extreme, any meetings of members coming

together to agree prices might be interpreted by the public as a cartel, with potential criminal consequences. I am sure that this was never intended when the members created Nominet but both the commercial world, and especially the internet, has moved, on. It seems that the Nominet membership has not, at least in corporate governance and economic regulation terms. The very Purpose of Nominet must be reconsidered to take account of the Public Interest.

A.3.2 Except for smaller companies, at least half the Board, excluding the Chairman, should comprise NEDs determined by the Board to be independent. A smaller company should have at least two independent NEDs.

BG: See above regarding size of Board and Independence.

A.3.3 The Board should appoint one of the independent NEDs to be the senior independent director. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of Chairman and Chief Executive or Finance Director has failed to resolve or for which such contact is inappropriate.

BG: Nominet cannot be compliant under its present constitution. It could be if the suggestion above for two independent directors is taken up.

A 4 Appointments to the Board

Main principle

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the Board.

BG: Whilst it can be argued that there is such a formal and transparent process it is seen by respondents to the Board self-evaluation as less than rigorous in selecting a balanced and experienced Board.

Supporting principles

Appointments to the Board should be made on merit and against objective criteria. Care should be taken to ensure that appointees have enough time available to devote to the job. This is particularly important in the case of chairmanships.

BG: In any membership-based organisation this is always a dilemma. On the one hand, the notion of the exercising of the democratic rights of the members allows for any candidate to put themselves forward with a manifesto for election to the Board. Under the Single Transferable Vote system chosen by the Nominet membership, and allowing for the chosen complexity of the vote calculation, the winners become directors. On the other hand, such a system is not compliant under the Combined Code. There are two main reasons for this. First, it allows an unbalanced mixture of directors, often inexperienced in board duties and processes, which can lead to 'capture' of a Board by a group whose primary loyalty is not to the company as a separate legal entity and who may pursue other goals, especially economic goals, contrary to the company's best interests and possibly with conflicts of interest. This can be alleviated by rigorous induction

and competence-building of the Board (e.g. developing the duties of Skill, Care and Diligence, and the commitments to Primary Loyalty and Collective Responsibility) but so far this has not been a high priority for the Nominet Board as the recent conflicts demonstrate. Indeed it appears that the current constitution works against this. Second, if the 'objective criteria' deal with the role of Nominet as an economic regulator then the resulting conflicts of interests seem irreconcilable without constitutional change.

This lack of clarity and rigour in the present selection process of agreed criteria for director selection and an apparent lack of understanding of the consequent directoral role is of major concern to me, especially as BERR is asking questions and will not go away.

The Board should satisfy itself that plans are in place for orderly succession for appointments to the Board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and the Board.

BG: See above

Code provisions

A.4.1 The should be a Nomination Committee which should lead the process for Board appointments and make recommendations to the Board. A majority of members of the Nomination Committee should be independent NEDs. The Chairman, or an independent NED, should chair the committee, the Chairman should not chair the Nomination Committee when it is dealing with the appointment of a successor to chairmanship. The Nomination Committee should make available its terms of reference, explaining its role and the authority delegated to it by the Board.

BG: This is a constitutional issue for Nominet which goes beyond the remit of the Nominations Committee. Do the membership want a more organised process for director selection and, ultimately, de-selection, specifically along the lines of a phased replacement of a percentage of the Board each year or two years? This seems to be the intention under Article 28 but in its present form is messy and needs clarification. A common way of handling this is for directors to be appointed for three years, subject to satisfactory annual appraisal, and then for a third of the Board to resign annually on an agreed rota (with special conditions created for the initial three years to allow the process to be instituted).

A.4.2 The Nomination Committee should evaluate the balance of skills, knowledge and experience of the Board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.

BG: This is essential for Nominet but difficult under its current constitution.

A.4.3 For the appointment of a Chairman, the Nomination Committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A Chairman's significant commitments should be disclosed to the Board before appointment and then included in the annual report. No individual should be appointed to a second chairmanship of a FTSE 100 company.

BG: Leaving aside the FTSE 100 recommendation I advise strongly that Nominet follows the rest of this provision. However, the current Nominet Constitution does not allow this as currently the members nominate and select four Board appointees without recourse to the board.

A.4.4 The terms and conditions of appointment of NEDs should be made available for inspection. The letter of appointment setting out the expected time commitment. NEDs should undertake that they have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed before appointments, with a broad indication of the time involved and the Board should be informed of subsequent changes.

BG: Acceptance of these terms by each director would have avoided some of the recent Nominet Board issues.

A.4.5 The Board should not agree to a full- time executive director taking on more than one NED directorship in a FTSE 100 company nor the chairmanship of such a company.

BG: I agree – and the general principle should apply to any other organisation public, private or not-for-profit.

A.4.6 A separate section of the annual report should describe the work of the Nomination Committee, including the process it has used in relation to Board appointments. An explanation should be given if neither an external search consultancy, nor open advertising has been used in the appointment of a chairman or a non-executive director.

BG: I agree, subject to Nominet’s constitution being amended in this manner.

A 5 Information and Professional Development

Main principle

The Board should be supplied in a timely manner with information and of a quality to discharge its duties.

All directors should receive adequate induction on joining the Board and should regularly update and refresh their skills and knowledge.

BG: I have commented on much of this already but, as there has been conflict on the Board, I suggest two things. First, that the Board adopts and adapts the ‘Learning Board’ model which I have described in Appendix 1 of the Nominet Governance Review. As this is used already by BERR, the Institute of Directors, ACEVO and others, it is well-tested. Second, that the Board considers carefully my detailed comments below:

Supporting principles

The Chairman is responsible for ensuring that the directors receive accurate, timely and clear information. Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.

BG: It is important that both NEDs and EDs use the Chairman as their focus of information for the Board. In Nominet, because currently there is little systematic checking by the Board over the integrity of the information given by management, two issues have created conflict. First, a feeling by some NEDs that only partial information has been generated on contentious issues. The constitutional role of the Executive Chairman has not helped perceptions here. Second, that some NEDs have in the past short-circuited the Chairman and Chief Executive's roles and authority by going directly to staff members for information. This is unwise as it can lead to the potential fragmentation of staff into supporters of rival NEDs. Reinforcing the Chairman as the primary source of integral information is advised strongly. Then any debate and challenge can be conducted openly around the boardroom table.

The Chairman is responsible for ensuring directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the Board and the Board committees. The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.

BG: The respondents to the Board Self-evaluation doubted that Nominet is compliant here. This principle is underplayed on most Boards. To achieve maximum effect it needs to be linked to Main Principle A 6 on performance evaluation. The Chairman is 'the architect of the Board' and is, therefore, ultimately responsible for its competence. This is achieved by at least annual Board and individual director evaluation so that their levels of knowledge, skills and attitudes can be assessed, benchmarked and their understanding of their complex directoral roles, and the necessary attitudes, checked. The good news is that the current Board Self-Evaluation provides a proven framework and benchmark from which Nominet can develop its own director development processes.

Under the direction of the Chairman, the company secretary's responsibilities should include ensuring good information flows within the Board and its Committees and between senior management and the NEDs, as well as facilitating induction and assisting with professional development as required.

BG: Nominet is compliant here. But, as a general comment, the role of the professional Company Secretary is often greatly misunderstood and abused by Boards. The Company Secretary is an officer of the Board, not a Director. That this role is often given to a director is not considered good practice as they rarely have the skills to handle the tasks required. Even if they do, they rarely have the time or the inclination to do the job professionally whilst handling their other directoral duties. This is no criticism of the current company secretarial role, which comes out well in the Board Self-evaluation.

The role should cover such 'administrative' aspects as: filing the necessary legal papers on time; creating Board agendas with the Chairman; and ensuring all directors have access to the agenda-setting process, as well as such 'facilitative'

aspects as: ensuring that directors have access to all information they require; giving professional legal advice where appropriate; and ensuring ‘professional’ aspects, such as updating and overseeing corporate governance compliance and acting as the ‘conscience of the Board’ if they are straying beyond the limits of their, and their company’s, legal remits.

Code provisions

A.5.1 The Chairman should ensure that new directors receive a full, formal and tailored induction on joining the Board. As part of this, the company should offer to major shareholders the opportunity to meet a new NED.

BG: Nominet is theoretically compliant here, except for the requirement that a new NED meets major shareholders, which is not appropriate. The first sentence is crucial and it is the quantity and quality of the present induction process that I am querying. This implies much more than the short sessions with the Chairman and Company Secretary plus an awful lot of reading. I am aware that most recent directors have had sessions with lawyers on their duties and responsibilities, and a one-day programme at the Institute of Directors but it is the move from such knowledge inputs to “living the role” which seems to me to be a weakness here. So personal benchmarking should start immediately, development plans be produced and a period of some six months allowed for the new director to bed down before assessing their competency – including EDs in their true directoral role. I shall stress the need for ED development *as directors* later. Some companies are experimenting with EDs having two employment contracts – one as a contract of employment for the bulk of their, executive, time; the other as the same contract for services as the NEDs. In this way the EDs enter the boardroom on the same terms as the NEDs.

A.5.2. The Board should ensure that directors, especially NEDs, have access to independent professional advice at the company’s expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.

BG: I have mentioned previously that in the Board Self-evaluation there was some confusion on this point. This provision is seen as good practice and is now spread widely. It helps also EDs to check their position if they have doubts about their dual roles as executives and directors. For all directors however it is not meant to be a process open to abuse through creating competitive legal opinions. The long-established concepts of Board collegiality and consensus must over-ride disputes. If a dissenter cannot get majority support from fellow directors, then they must leave the Board and, if desired, fight for the votes of the owners/members by seeking re-election to the Board on the issue that they wish to pursue, In Nominet’s case matters seem to have become unbalanced in favour of corporate legal issues (perhaps because of the predominance of corporate lawyers on the Board and the signs of an attitude that if you only have a hammer all problems tend to look like nails) at the expense of the development of Policy, Strategic and Financial issues as the Learning Board model advocates. I advise that any fees for independent professional advice are published in the annual report for membership scrutiny so that the identity of those directors seeking external advice on their roles is clear.

A.5.3 All directors should have access to the advice and services of the company secretary, who is responsible to the Board for ensuring that Board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the Board as a whole.

BG: Nominet is compliant here. The Company Secretary is subject to the annual 360 degree appraisal just as are the directors.

A 6 Performance Evaluation

Main Principle

The Board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

BG: Nominet is becoming compliant under the annual Board self-evaluation process. It will ensure that all three aspects of the necessary evaluation – the Board, the committees and individual directors - can be benchmarked for future annual evaluation. This is a key principle for determining the effectiveness of any Board and needs to be accepted contractually by all directors as part of their commitment to their directoral duties.

Supporting principle

Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for Board and committee meetings and any other duties). The Chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the Board and, where appropriate, proposing new members be appointed to the Board or seeking the resignation of directors.

BG: Whilst it is easy to accept this principle, it is more difficult for any Board to be seen to live it. The current Board Self-evaluation process will give a well-proven basis for Nominet to develop its own future evaluation structure and processes. In addition to reporting simply that a Board evaluation has taken place, many Boards publish in their annual reports limited additional information such as the attendance record of each director at Board and committee meetings. Some, like BAe, go much further and publish a development statement for the Board. I have given a current example from the 2007 BAe plc annual report at the end of this paragraph to show the most detailed of such statements from a UK FTSE 100 company. But most keep the detailed analyses within the Board itself. There are two main reasons for this. First, to ensure that trust and confidentiality is maintained around the boardroom table without the concern that the owners or stakeholders will have access to it. Second, because of concerns over what can be published under the Data Protection Act and, even, the Human Rights Act. This must be an issue for a membership-based organisation where a balance must also be struck in terms of freedom of information for members. In addition, two questions need to be asked - should the Board decide to recommend a 'slate' of potential Board members as a way of ensuring continuing competence and balance on the Board, or should it be left entirely to the membership to put up for election any member who wishes to stand?

BAe Systems disclosed its Objectives for the previous year and reported what happened in achieving them and gave their plans for Board development in 2008. The former included succession planning, key performance indicators, non-financial performance monitoring and more opportunities for non-executives to meet the CEO. The latter included engagement to choose the new CEO, site visits, understanding the requirements to support the company's global position, the ethical and reputational implications of strategic growth (including embedding the Woolf Committee's recommendations) and a continuing focus on key performance indicators.

Code provisions

A.6.1 The Board should state in the annual report how performance evaluation of the Board, its committees and its individual directors has been conducted. The NEDs, led by the senior independent director, should be responsible for the evaluation of the Chairman, taking into account the views of the EDs.

BG: Nominet is not compliant here, but the Board Self-evaluation has set these processes in motion. The Combined Code is silent on the key issues of the content and process of Board evaluation and focuses on the publication on the fact that it has happened. I know of no Board which publishes the results of the individual director evaluations (for the reasons mentioned above). I note that the Board has as a part of the NED's contract the obligation to have an annual, personal 360 degree appraisal. Indeed, it was the refusal of one NED to sign such a contract which caused some of the recent dissension.

As for the review of the Chairman, he has complied with the annual 360 degree appraisal requirement. However, as there is not yet an agreed senior independent director and, as the Chairman is also under the constitution the Managing Director, it is not possible for Nominet to be compliant in this area.

A 7 Re-election

Main Principle

All directors should be submitted for re-election at regular intervals subject to continued satisfactory performance. The Board should ensure planned and progressive refreshing of the Board.

BG: Nominet is not yet compliant here until the Board evaluation of individual directors is completed on a regular basis. I have based my comments about re-election on the assumption that Nominet will set up the necessary Board evaluation processes to drive it properly. The issue of the 'planned and progressive refreshing of the Board' raises specific issues for Nominet and its current constitution. I advocate using this Principle as it stands, and amending the Nominet constitution (Articles 27–30) to include it. It should help avoid the situation where a majority of directorally inexperienced directors are appointed to the Board. The Constitution reflects the need for a process where a percentage of directors retire annually to ensure refreshment of the Board but it would be better if it did not trigger automatically a fully contested election and allowed the Board to make its own recommendations to the membership as to who they thought best to enhance the Board whilst leaving the final decisions to the vote of the membership.

Core provisions

A.7.1 All directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. The names of directors submitted for re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.

BG: See my comments immediately above. This links with A.7.2 below. In addition, a detailed job specification for members standing for election to a directorship should reinforce the roles, tasks, duties and liabilities involved. The biographical details of both elected and appointed directors should stress examples of both the managerial and directoral experiences of each candidate; and should give an early indication of any conflicts of interest for each candidate.

A.7.2 NEDs should be appointed for specified terms subject to re-election and to Companies Acts provisions relating to the removal of a director. The Board should set out to shareholders in the papers accompanying a resolution to elect a NED why they believe an individual should be elected. The Chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role. Any term beyond six years (e.g. two three- year terms) for a NED should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the Board. NEDs may serve longer than nine years (e.g. three three-year terms), subject to the determination of an NED's independence (as set out in provision A.3.1).

BG: I agree, as mentioned above. But this all depends on establishing independence of thought and primary loyalty in all directors and in the membership accepting the importance of such information.

SECTION B

NB: From this point I argue that the 2006 Combined Code becomes less relevant for Companies Limited By Guarantee. However, both for the sake of completeness and because there are some workable ideas for Nominet's consideration in the next two Sections I have commented on them.

B. REMUNERATION

B.1 The Level and Make-Up of Remuneration

Main Principles

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of the ED's remuneration should be structured so as to link rewards to corporate and individual performance.

Supporting principles

The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution, in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance. They should also be sensitive to pay and employment conditions elsewhere in the group, especially when the determining annual salary increases.

BG: Nominet is compliant here. These are sound principles and should form the basis of the remuneration committee's analysis and recommendations to the Board. However, I express below some concern over the remuneration committee's experience in this area.

Code provisions

B.1.1 The performance-related elements of remuneration should form a significant proportion of the total remuneration package of EDs 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. In designing schemes of performance-related remuneration, the remuneration committee should follow the provisions in Schedule A of this code (page 47).

BG: There is a need for the reconsideration and the reinforcement of the processes of the remuneration committee. It needs at least one person with relevant HR/compensation experience on it. The membership needs only to look outside to the Credit Crunch issues of ill-considered remuneration practices to see how important this role is in maintaining a healthy organisation. Remuneration is one of those areas which can never be seen to be perfect and is, therefore, always a source of disagreement, especially with the EDs. The Committee needs, therefore, reliable information, independence of thought and tough judgement to fulfil its task. It is to ensure such a situation that I make this suggestion.

Otherwise, to quote the old remuneration joke, “if you have a remuneration committee with a loaded wallet and a group of EDs with a loaded revolver, guess who wins every time?”.

B.1.2 Executive share options should not be offered at a discount save as permitted by the relevant provisions of the Listing Rules.

BG: Not applicable

B.1.3 Levels of remuneration for NEDs should reflect the time commitment and responsibilities of the role. Remuneration for NEDs, should not include share options. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shared acquired by exercise of the options should be held until at least one year after the NED leaves the Board. Holding of share options could be relevant to the determination of a NED’s independence (as set out in provision A.3.1).

BG: Not applicable in relation to shares. However, consideration does need to be given in terms of the time commitments needed to become an effective NED and thus the appropriate remuneration.

B.1.4 Where a company releases an ED to serve as a NED elsewhere, the remuneration report should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is.

BG: This is good practice and exists in Nominet.

Service Contracts and Compensation

B.1.5 The remuneration committee should consider carefully what compensation commitments (including pension contributions and all other elements) their director’s terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing director’s obligations to mitigate loss.

BG: Again this is good practice and should be adopted. Remember, also, the comments I made on all directors, whether NED or ED, having the same contracts for services as a director.

B.1.6 Notice of contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.

BG: Again, good practice but Nominet is not compliant as NEDs are elected for a fixed period of two years although if they have signed their contract, earlier termination is provided for.

B 2 PROCEDURE

Main Principle

There should be 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.

BG: This is a fundamental principle which Nominet accepts and is compliant.

Supporting principles

The remuneration committee should consult the Chairman and/or Chief Executive about their proposals relating to the remuneration of other EDs. The remuneration committee should also be responsible for appointing any consultants in respect of ED remuneration. Where EDs or senior management are involved in advising or supporting the remuneration committee, care should be taken to recognise and avoid conflicts of interest.

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.

BG: All good practice, which Nominet applies as best it can given that it has no shareholders.

Code provisions

B.2.1 The Board should establish a remuneration committee of at least three, or in the case of smaller companies, two independent NEDs. In addition, the company Chairman may also be a member of, but not the chair, the committee if he or she is considered independent on appointment as Chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the Board. Where remuneration consultants are appointed, a statement should be made available of whether they have any other connections with the company.

BG: Under the present constitution Nominet cannot be compliant here as the creation of truly 'independent' directors seems impossible. Together with the skills gap of the majority of directors in this area, this is a current weakness of Nominet.

B.2.2 The remuneration committee should have delegated responsibility for setting remuneration for all EDs and the Chairman, including pension rights and any compensation payments. The committee should also recommend and monitor the level and structure of remuneration of senior management. The definition of 'senior management' for this purpose should be determined by the Board but should normally include the first layer of management below Board level.

BG: This is good practice and although followed previously since the meeting of December 2008 is included in the remuneration committee's terms of reference.

B.2.3 The Board itself, or where required by the Articles of Association, the shareholders, should determine the remuneration of the NEDs within the limits set by the Articles of Association. Where permitted by the Articles, the Board may however delegate this responsibility to a committee, which might include the Chief Executive.

BG: Nominet is compliant here.

B.2.4 Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules) and significant changes to existing schemes, save in the circumstances permitted in the Listing Rules.

BG: Again, good practice. It could be made to work for Nominet if the word 'membership' is substituted for 'shareholders'. However, as Nominet has no shares they cannot suffer dilution on the granting of share options, nor suffer dilution in the value of their membership. The Board decided, therefore, that it was neither appropriate or practical to comply with this aspect of the Code.

C ACCOUNTABILITY AND AUDIT

C.1 Financial Reporting

Main Principle

The Board should present a balanced and understandable assessment of the company's position and prospects.

BG: Nominet is compliant here. However, taken with the Companies Act 2006 provision that the Board and directors must state in the annual report that the company is a 'going concern', and must explain the associated risks, this becomes now a more serious burden for directors both corporately and individually. Nominet must ensure that the selection of future directors makes this duty clear and spells out the personal consequences of it.

Supporting Principle

The Board's responsibility to present a balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as information required to be presented by statutory requirements.

BG: Not applicable at present. However, the 'report to regulators' part may soon become an issue for Nominet.

Code provisions

C.1.1 The directors should explain in the annual report their responsibility for preparing the accounts and there should be a statement by the auditors about their reporting responsibilities.

BG: See comment above under Main Principle.

C.1.2 The directors should report that the business is a going concern, with supporting assumptions or qualifications as necessary.

BG: See comments under Main Principle above.

C. 2 Internal Control

Main principle

The Board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets

BG: This is a key part of the maintenance of the 'prudent control' systems of Nominet. The respondents to the Board Self-evaluation said that the current financial systems were effective and wanted them maintained under the new Finance Director.

Code provision

C.2.1 The Board should, at least annually, conduct a review of the effectiveness of the group's system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and the risk management systems.

BG: Although Nominet is seen as compliant here, and it was noted in the Board Self-evaluation that developments are in hand to enhance the quality of the risk management system.

C.3 Audit Committee and Auditors

Main Principle

The Board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.

BG: Nominet is compliant here. However, I am concerned with the slim amount of financial experience on the Board and the seeming lack of it on the Audit Committee. So although the Board can be said to have the systems, including the audit system, in place I am unsure at the effectiveness of these systems, especially as the Chairman has also the Managing Director role, even if it is rarely used.

March 2009 Update:

The recent appointment of an independent director with considerable financial experience is a positive sign. In addition, the positive reports from the external auditors on Nominet's systems are a reassurance for the membership.

Code provisions

C.3.1 the Board should establish an audit committee of at least three, or in the case of smaller companies two, members, who should all be independent NEDs. The Board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.

BG: See comments above. Nominet cannot be fully compliant under this provision under its current constitution.

C.3.2 the main role and responsibilities of the audit committee should be set out in written terms of reference and should include:

- *to monitor the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;*
- *to review the company's internal financial controls and unless expressly addressed by a separate Board risk committee, or the Board itself, to review the company's internal control and risk management systems:*
 - *to monitor and review the effectiveness of the company's internal audit function;*
 - *to make recommendations to the Board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;*
 - *to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;*
 - *to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of the non-audit services by the external audit firm; and to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.*

BG: Despite the respondents' feelings that the integrity of the financial information systems is currently acceptable, whilst the new Finance Director is proving his understanding and integrity this aspect of the director's system of the "prudent control" of Nominet looks potentially fragile to me and is in need of careful continuous oversight.

C.3.3 The terms of reference of the audit committee, including its role and the authority delegated to it by the Board, should be made available. A separate section of the annual report should describe the work of the committee in discharging those responsibilities.

C.3.4 *The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-on action.*

BG: Nominet is partly compliant here but the Board should ensure that it is always up to date with Government legislation in this area.

C.3.5 *The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the Board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.*

BG: As in C.3.4 above. In a membership-based organisation with the whole idea of directoral independence being in doubt because of the constitution this is an important safeguard to construct for the benefit of the company and the members.

C.3.6 *The audit committee should have the primary responsibility for making a recommendation on the appointment, re-appointment and removal of the external auditors. If the Board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the Board has taken a different position.*

C.3.7 *The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.*

BG: Both of the above are good practice and must be maintained.

D. RELATIONS WITH SHAREHOLDERS

NB: This is a difficult area to translate into 'membership' terms. But I have tried to do so by focusing on the Nominet membership as the generic 'shareholder' term here; and in using 'stakeholder' as a reference to the wider civic community i.e. 'the public good' as seen by the Government, Nominet users, etc.

Main Principle

D.1 Dialogue with Institutional Shareholders

There should be a dialogue with shareholders based on the mutual understanding of objectives. The Board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.

BG: Nominet is compliant here through its use of its general meetings, information days, top twenty events etc. However, the effectiveness of the Policy Advisory Body process is in need of strengthening in the areas of 'horizon-scanning' and relations with the wider stakeholder community. I suggest that Nominet adopts consciously such an approach for its membership and reinforces the 'horizon-scanning' role of the PAB. This would increase the mutual information flows and

decrease the speculative and debilitating chatter which pervades aspects of the Nominet membership. Despite the wonders of the internet there seems a downside, that continuous, instant and ill-considered electronic chatter on various websites is undermining in the minds of the wider community of stakeholders the many achievements of the company, the credibility of Nominet's governance and thus the ability of the membership to achieve their aspirations.

Supporting principles

Whilst recognising that most shareholder contact is with the Chief Executive and Director of Finance, the Chairman (and the senior independent director and other directors as appropriate) should maintain sufficient contact with major shareholders to understand their issues and concerns.

The Board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.

BG: In a membership organisation it is important that the members' opinions are focused through the Board in the first instance rather than short-circuiting the executive system by imposing on it random and often onerous demands for information, it is the Board's task to seek patterns in members' needs for information and to ensure prudent control of the executive's responses and actions. I reiterate, a reconsideration of the Policy Advisory Body role in relation to dialogue with the membership is needed.

Code provisions

D.1.1 The Chairman should ensure that the views of shareholders are communicated to the Board as a whole. The Chairman should discuss governance and strategy with the major shareholders. Non-executive directors should be offered the opportunity to attend meetings with major shareholders and should expect to attend them if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.

BG: I agree that the Chairman should lead on corporate communications both to the membership and the wider community. In Nominet's case the issue of 'major shareholders' and their rights to more information is addressed in the Mutuo study. It is a controversial issue in a membership-based organisation so I shall not go into here other than to state my opinion that in a membership-based organisation all members should have equal access to information and the consequent debate regardless of the size of their vote.

D.1.2 The Board should state in the annual report the steps they have taken to ensure that the members of the Board, and in particular the NEDs, develop an understanding of the views of major shareholders about their company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.

BG: See comments above.

D. 2 Constructive use of the AGM

Main principle

The Board should use the AGM to communicate with investors and to encourage their participation.

BG: Nominet is compliant in all main aspects here, even though it has chosen a complex voting system.

D.2.1 At any general meeting, the company should propose a separate resolution on each substantially separate issue, and should in particular propose a resolution at the AGM relating to the report and accounts. For each resolution, proxy appointment forms should provide shareholders with the option to direct their proxy to vote either for or against the resolution or to withhold their vote. The proxy form and any announcement of the results of a vote should make it clear that a “vote withheld” is not a vote in law and will not be counted in the calculation of the proportion of votes for and against the resolution.

D.2.2 The company should ensure that all valid proxy appointments received for general meetings are properly recorded and counted. For each resolution, after a vote has been taken, except where taken on a poll, the company should ensure that the following information is given at a meeting and made available as soon as reasonably practicable on a website which is maintained by or on behalf of the company:

- *the number of shares in respect of which proxy appointments have been validly made;*
- *the number of votes for the resolution*
- *the number of votes against the resolution; and*
- *the number of shares in respect of which the vote was directed to be withheld.*

D.2.3 The Chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.

D.2.4 The company should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting.

BG: Whilst Nominet is compliant with all the four sections above its current problems with the membership suggest that more creative, interactive solutions need to be found for better quality dialogue between the company and the membership and with the wider stakeholder community. I note that an attempt to achieve this is through the web-casting of the AGMs to the membership.

SECTION 2 INSTITUTIONAL SHAREHOLDERS

Main principle

Institutional shareholders should enter into a dialogue with companies based on a mutual understanding of objectives.

BG: Nominet cannot be compliant here as this section does not apply. There is a separate issue here as to whether institutional shareholders can be bound by the Code – but that is another argument beyond the boundaries of Nominet.

THE SCHEDULES

Schedule A: Provisions on the design of the performance related remuneration

- 1. The remuneration committee should consider whether the directors should be eligible for annual bonuses. If so, performance conditions should be relevant, stretching and designed to enhance shareholder value. Upper limits should be set and disclosed. There may be a case for part payment in shares to be held for a significant period.*
- 2. The remuneration committee 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 less than 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 liabilities.*
- 3. Any new long-term incentive schemes which are proposed should be approved by shareholders and should preferably replace any existing schemes or at least form part of a well considered overall plan, incorporating existing schemes. The total rewards potentially available should not be excessive.*
- 4. 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. Consideration should be given to criteria which reflect the company's performance relative to a group of comparator companies in some key variables such as total shareholder return.*
- 5. Grants under executive share option and other long-term incentive schemes should normally be phased rather than awarded in one large block.*
- 6. In general, only basic salary should be pensionable.*
- 7. The remuneration committee should consider the pension consequences and associated costs to the company of basic salary increases and any other changes in pensionable remuneration, especially for directors close to retirement.*

Schedule B: Guidance on liability of non-executive directors. Care, skill and diligence

1. *Although NEDs and EDs have as Board members the same legal duties and objectives, the time devoted to the company's affairs is likely to be significantly less for a NED than for an ED and the detailed knowledge and experience of the company's affairs that can be reasonably expected of a NED is likely to be significantly less than for an ED. These matters may be relevant in assessing the knowledge, skill and experience which may be expected reasonably of a NED and therefore the care, skill and diligence that a NED may be expected to exercise.*
2. *In this context, the following elements of the Code may also be particularly relevant.*
 - (i) *In order to enable directors to fulfil their duties, the Code states that:*
 - *The letter of appointment of the director should set out the expected time commitment (Code provision A4.4): and*
 - *The Board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. The Chairman is responsible for ensuring that the directors are provided by management with accurate, timely and clear information (Code principle A.5).*
 - (ii) *NEDs should themselves:*
 - *Undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company (Code principle A.5 and provision A.5.1)*
 - *Seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice (Code principle A.5 and provision A.5.2)*
 - *Where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, ensure that they are recorded in the Board minutes. (Code provision A1.4)*
 - *Give a statement to the Board if they have such unresolved concerns on resignation (Code provision A.1.4)*
3. *It is up to each NED to reach a view as to what is necessary in particular circumstances to comply with the duty of care, skill and diligence they owe as a director to the company. In considering whether or not a person is in breach of that duty, a court would take into account all relevant circumstances. These may include having regard to the above where relevant to the issue of liability of a NED.*

Schedule C: Disclosure of corporate governance arrangements

Paragraph 9.8.6 of the Listing Rules states that in the case of a listed company incorporated in the United Kingdom, the following items must be included in the annual report and accounts:

- *A statement of how the listed company has applied the principles set out in Section 1 of the Combined Code, in a manner that would enable shareholders to evaluate how the principles have been applied,*
- *A statement as to whether the listed company has:*
 - *complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code*
 - *not complied throughout the accounting period with all relevant provisions set out in Section 1 of the Combined Code and if so, setting out:*
 - (i) *those provisions, if any, it has not complied with*
 - (ii) *in the case of provisions whose requirements are of a continuing nature, the period within which, if any, it did not comply with some or all of the provisions; and*
 - (iii) *the company's reasons for non-compliance.*

In addition the Code includes specific requirements for disclosure which are set out below:

- *a statement of how the Board operates, including a high level statement of which types of decisions are taken by the Board and which are to be delegated to management (A.1.1)*
- *the names of the Chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen of the nomination, audit and remuneration committees (A.1.2)*
- *the number of meetings of the Board and those committees and individual attendance by the directors (A.1.2)*
- *the names of the NEDs whom the Board determines to be independent, with reasons where necessary (A.3.1);*
- *the other significant commitments of the Chairman and any changes to them during the year (A.4.3);*
- *how performance evaluation of the Board; its committees and its directors has been conducted (A.6.1);*
- *the steps the Board has taken to ensure that members of the Board, and in particular the NEDS, develop an understanding of the views of the major shareholders about their company (D.1.2)*

The report should include:

- *a separate section describing the work of the nomination committee, including the process it has used in relation to Board appointments and an explanation if neither external search consultancy nor open advertising has been used in the appointment of a chairman or NED (A.4.6);*
- *a description of the work of the remuneration committee as required under the Director's remuneration report Regulations 2002, and including, where an executive director serves as a NED elsewhere, whether or not the director will retain such earnings and, if so, what the remuneration is (B.1.4);*
- *an explanation from the directors of their responsibilities for preparing the accounts and a statement by the auditors about their reporting responsibilities (C.1.1);*
- *a statement from the directors that the business is a going concern, with supporting assumptions or qualifications as necessary (C.1.2);*
- *a report that the Board has conducted a review of the effectiveness of the group's system of internal controls (C.2.1);*
- *a separate section describing the work of the audit committee in discharging its responsibilities (C.3.3)*
- *where there is no internal audit function, the reasons for the absence of such a function (C.3.5);*
- *where the Board does not accept the audit committee's recommendation on the appointment, re-appointment or removal of an external auditor, a statement from the audit committee explaining the recommendation and reasons why the Board has taken a different position (C.3.6); and*
- *an explanation of how, if the auditor provides non-audit services, auditor objectivity and independence is*

The following information should be made available (which may be met by placing the information on a website that is maintained by or on behalf of the company):

- *the terms of reference of the nomination, remuneration and audit committees, explaining their role and the authority delegated to them by the Board (A.4.1, B.2.1 and C.3.3);*
- *the terms and conditions of appointment of NEDs (A.4.4); and*
- *where remuneration consultants are appointed, a statement of whether they have any other connection with the company (B.2.1)*

The Board should set out to shareholders in the papers accompanying a resolution to elect or re-elect directors:

- *sufficient biographical details to enable shareholders to take an informed decision on their election or re-election (A.7.!);*

- *why they believe an individual should be elected to a NED role (A.7.2); and*
- *on re-election of an NED, confirmation from the chairman that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role, including commitment of time for Board and committee meetings and any other duties (A.7.2).*

The Board should set out to shareholders in the papers recommending appointment or re-appointment of an external auditor:

- *If the Board does not accept the audit committee's recommendation, a statement from the audit committee explaining the recommendation and from the Board setting out reasons why they have taken a different position (C.3.6).*

SUGGESTED ACTIONS FROM THIS COMPARISON AND THE BOARD SELF-EVALUATION.

I was asked to suggest any actions I thought that the Nominet Board should take following this comparative Review. I have gone beyond looking just at the Combined Code as most of the actions that I suggest cannot be taken without some reform of Nominet's Constitution – which I see as the biggest blockage to Nominet's survival.

Remembering that Nominet is not bound by the principles and provisions of the 2006 Combined Code, I make the following suggestions for debate and action by the membership for two reasons:

- To ensure that Nominet is following good corporate governance practice regardless of the detailed Code provisions. I acknowledge that 'good practice' is not always 'best practice' but it has developed in many organisations and countries for well-proven reasons. The suggestions that I am making are all based on proven practice in organisations of all types.
- To enable it to position itself for a more 'political' future in relation to the growing power of its stakeholders beyond the boundaries of the membership.

The Suggested Changes:

a) To split the present Chairman and Managing Director role

Currently this combined role is built into Nominet's constitution. However, having a combined role is considered bad practice in modern corporate governance circles as it concentrates too much power into one pair of hands at the head of a business. Indeed, the splitting of these roles has been mandatory for listed companies since 1992. I note that the present Chairman, who in other companies has worked under the 2006 Code, has tried hard to play only the Chairman role. Yet this is not what Nominet's constitution demands. It seems very unwise that Nominet continues what is seen as bad practice here. It reflects badly on Nominet as it does not allow for either role to be developed fully nor for effective Board oversight of each role.

b) To create a separate role of Managing Director who is a full Board member

Again, this is good corporate governance practice and mandatory under the 2006 Combined Code. If the Chairman is 'the boss of the Board of Nominet' then the Managing Director is 'the boss of the day-to-day operations of Nominet' and is held fully accountable for them. This suggestion would require that the Managing Director becomes a statutory Board member, and that the current role of Chief Executive is absorbed into the MD role.

- c) **To revise Nominet's system of voting for directors so that it is compliant with both the words and spirit of the UK's 2006 Companies Act and the Combined Code in relation to conflicts of interest**

This is designed to clarify the present position in Nominet where a conflict can be acknowledged but the Board has currently no power to do anything about it. I am suggesting, for example, the keeping of a register of interests of Board members, the updating of these at each Board meeting and having a clear process for deciding if a conflicted Board member may speak to a topic, whether they can vote on a specific issue, and that these decisions are recorded in the Board minutes.

- d) **The Board to have the power to appoint at least two experienced and independent NEDs to the Board in addition to the present NED composition**

There are four reasons for making this proposal:

First, to add wider diversity to the industry-specific experience of directors elected from the membership. This is always an issue in membership-based organisations as many elected directors do not have any previous directoral experience.

Second, to allow Nominet to be seen to be acknowledging their wider role in creating the 'public good' by bringing in some externally-orientated directors with their critical, independent oversight to balance the Board's risk assessment and decision making processes.

Third, to give the Board flexibility in bringing specific functional experience onto it where there is an obvious need.

Fourth, to allow the appointment of a Senior Independent Director who can act as a point of contact for members wishing to discuss issues such as the performance of the Chairman.

I suggest that good practice for these independent NEDs is that they are part of the Board's annual evaluation, and that they have a maximum term of three three-year contracts subject to satisfactory performance.

March 2009 Update:

I note that a new NED with significant financial experience has been appointed to the Board.

- e) **To ensure that the Board has on it three Executives who are also statutory directors**

This is a further step in achieving better balance on the Board by having the Managing Director and other supporting roles as Board members as part of their employment contract. This would allow broader regular Board oversight mechanisms of the business and the development of Nominet.

f) To appoint a professionally-trained Company Secretary as an Officer of the Board

This role has proved crucial in many Boards, especially those onto which many members may be appointed without previous directoral experience. The Company Secretary is expected to ensure good practice and legal compliance around the boardroom table and to act as ‘the conscience of the Board’ when necessary.

g) To create a clear job description for each director

This is to go beyond the existing job description that is contained currently within the call for members’ nominations to the Board. It needs to state their corporate legal duties and responsibilities, time commitments and the personal liabilities to which they will be committed. Such job descriptions must apply equally to the Chairman, the Managing Director and any other executives who are statutory directors.

h) To create annual evaluation and development plans for the Board itself, each committee and each individual director

This is standard practice and is contained in, for example, the Combined Code, the NHS Monitor Code, and please note DBERR’s *Building Better Boards* recommendations. They, and others, advocate using the *Learning Board Model* in which I declare an interest (see Appendix 1 of the Nominet Governance Review).

i) To ensure that the Board nomination, selection, induction, competence building, evaluation, renewal and de-selection processes are reviewed regularly

This can be started immediately without the need for constitutional change.

j) To publish in the Annual Report the reasons for, and cost of, the legal fees for directors seeking independent advice concerning their directoral roles

This is to make these costs transparent and, given the recent experiences, to demonstrate the future effectiveness of the induction and competence building processes. Hopefully, it will reduce the tendency to litigation amongst future directors.

k) To review and publish the remit and membership criteria of the Audit, Remuneration and Nominations Committees.

In March 2009, I realise that a start has been made on the Audit Committee. In many businesses it has been found wise to combine the Nominations and Remuneration Committees.

l) To reconsider the role and processes of the Policy Advisory Body so that it becomes more an ‘outward facing’ part of the membership’s connection and sensitivity to the external stakeholders and the public good.

But none of these is worth worrying about for too long unless the membership face up to the changed and changing external environment, and their consequent need to adjust their role and their constitution to cope with this.

I argue strongly that these corporate governance revisions to ensure compliance with good practice externally are needed now.

These suggested changes can also be found in my Nominet Governance Review.

Professor Bob Garratt

Following Board composition changes updated April 2009