中電控股
CLP Holdings

31 March 2004

The Stock Exchange of Hong Kong Ltd.,
11/F., One International Finance Centre,
1 Harbour View Street, Central,
Hong Kong.

香港九龍亞皆老街一四七號
147 Argyle Street, Kowloon, Hong Kong
電話 Tel (852) 2678 8584
傳真 Fax (852) 2678 8186
網址 Website www.clpgroup.com

Attention : The Listing Unit

Dear Sirs,

Exposure of Draft Code on Corporate Governance Practices and Corporate Governance Report

I refer to the Exchange's letter of 4 February 2004, enclosing an Exposure Paper setting out a draft Code on Corporate Governance Practices ("the Code") and draft Rules on the Corporate Governance Report. This letter sets out our comments in response to the Exposure Paper.

Before doing so, I should note that I and my colleague, Mrs. April Chan, had an opportunity to review and comment on earlier drafts of the Code, through our participation in the working group set up in the latter part of 2003 by the Exchange for this purpose. Although we have not had the time to undertake a direct comparison of the draft Code which emerged from the working group review, compared to the present draft, our overall impression is that the earlier draft was a more comprehensive and cohesive document. We assume that the subsequent changes to the draft Code have reflected a need to consult and take into account comments from, other stakeholders in this process.

The Exposure Paper requests comments in response to three specific questions. Each of these is addressed below.

Q.1 Do you support the proposed implementation timetable?

1. We assume that the implementation timetable will be the same both for the Code and Corporate Governance Report and that the intent of para. 16 of the Exposure Paper is that the first occasion on which issuers will need to report on compliance with the Code and to publish a Corporate Governance Report will be in their first Annual Report & Accounts which fall to be published on or after 1 January 2006.

2. On this basis, we support the proposed implementation timetable. We had had an earlier concern that the implementation timetable might have involved listed issuers being required to report by reference to the Code in respect of a previous accounting period in which the Code had only been issued partway through. It would have been impractical and unfair to have required issuers to report by reference to a Code which had not actually been in place for part of the year covered by the relevant Annual Report & Accounts. We are pleased that the Exchange has adopted an implementation timetable which will give issuers a full

year, following the formal announcement of the Code, in which to organize their affairs by reference to the Code and then report on compliance.

Q.2 Do you support the presentation and format of the draft Code and Corporate Governance Report? If not, please provide details of your concerns and recommendations.

3. We support the organization of the Code into Code Provisions (subject to a "comply or explain" requirement) and Recommended Best Practices (which issuers are encouraged to adopt or to disclose deviation). This is the approach adopted in the U.K. combined Code and seems to be a sensible overall structure for the Code.

4. Our first structural concern relates to the Exchange's proposals that issuers may devise their own codes only if these are in no less exacting terms in all respects than the Code (last paragraph on page 7 of the Exposure Paper). Our objection to this is not easy to explain, but we will try : -

- The Code Provisions are not mandatory (the obligation is to comply or explain deviation);
- Therefore, it is illogical to make it mandatory that issuers' own codes are no less exacting than the Code;
- In the case of CLP (and possibly many other issuers) we would like to devise our own Code, which reflects the application and adaptation of good corporate governance practices to our own needs and circumstances. It is quite possible that there may be occasionally elements of the Code Provisions with which, for good reasons, we might decide not to comply. Equally, there will be many areas where our own practices will exceed those set out in the Code Provisions. As currently structured, the Exposure Paper would prevent CLP devising it own code. To take wider example, issuers which do not have separate chairman and chief executive officers (Code Provisions A.2.1) would never be able to devise their own codes, even if they matched or exceeded the Code Provisions in every other respect;
- Put another way, there are 49 Code Provisions. If an issuer has practices which exceed 48 of these, but fails to meet one, he can never adopt his own code. Instead, he is obliged to adopt and report by reference to the Code, even though in 48 respects his own practices are more exacting. This leaves the issuer with two options, neither of which seems ideal. The first is to explain in the Corporate Governance Report the 48 instances where the issuer has actually adopted stronger practices than those in the Code. The second would be to restate his own code to follow the Code wording regarding the one element where he is non-compliant (even though the issuer knows he will not follow the Code practice in this respect) and then report deviation from this each year in his Corporate Governance Report.

5. The proper approach to deal with this would be to provide that issuers may devise their own Codes on Corporate Governance Practices but their Corporate Governance Reports must disclose and explain any areas in which the issuers' own code is less exacting than the Code Provisions.

6. The advantage of doing this is that it will encourage issuers to devise their own codes and, in doing so, take on the responsibility of considering, formulating and publishing Codes of Corporate Governance Practices which have been designed and drafted to meet their own particular requirements and standards. At the same time, no disadvantage results to existing or potential shareholders, since the Corporate Governance Report will expressly disclose and explain any areas where such codes are less exacting than the Code. If this structural change is not implemented, issuers will be discouraged from developing their own codes, including ones in which the majority of the term may well be more exacting than those set out in the Code. For example, in CLP's case, if we were to produce our own code, many of the Recommended Best Practices would actually be expressed by us as clear commitments (such as, to take one example, the recommendation to establish a nomination committee set out in para. A.4.4 of the Exposure Paper, a practice to which we are just as committed as other elements of corporate governance which the Exchange proposes to categorise as Code Provisions).

7. Our second structural concern relates to the Corporate Governance Report. Para. 20 (page 6) of the Exposure Paper notes that the Corporate Governance Report consists of three levels of disclosure requirements. We have some difficulty with the second level, including whether it is actually necessary to have this intermediate level at all : -

- It seems strange to have the notion of provisions which an issuer is not obliged to disclose, but is obliged to explain any non disclosures. In other words (perhaps expressed a little unfairly), an issuer need not disclose, but has to disclose why he hasn't disclosed;
- In practice, explaining a non-disclosure may often amount to the same thing as disclosure in the first place; and
- The requirement, in the second level of the Corporate Governance Report, to explain non disclosure may be identical to the "comply or explain" concept of the Code Provisions. In this respect we note that each of the four requirements listed at para. 3 on page 40 of the Exposure Paper is a Code Provision.

8. Our suggestion is to eliminate the second level of the Corporate Governance Report. Requirements, such as those presently listed in para. 3 on page 40 of the Exposure Paper, which are Code Provisions, should be included in the first level of the Corporate Governance Report. Although this is not presently the case with the Exposure Paper, any second level requirements of the Corporate Governance Report which corresponded only to Recommended Best Practices, should be transferred to the third level of the Corporate Governance Report.

9. The effect of doing this would be that, like the proposed Code, the Corporate Governance Report would then be a two-tier structure, with conformity and consistency between the "tiering" of both the Code and the Corporate Governance Report.

10. Our third comment on structure or format, relates to the Corporate Governance Report. Para. 20 on page 6 of the Exposure Paper notes that the "the format and the content of the Corporate Governance Report are not prescriptive". We hope that this means that the contents of the Corporate Governance Report may be set out across different sections of the Annual Report (possibly, although this will not be strictly necessary, on the basis of cross references expressed in the Corporate Governance Report). In CLP's case, for example, we have included a "Remuneration Report" in our Annual Report, which groups together all relevant information for shareholders regarding the remuneration of non-executive directors, executive directors and senior management. This remuneration report also includes the auditable elements of directors' and senior management's remuneration, which would otherwise be set out in the Notes to the Accounts. We feel that such a remuneration report is a practical and sensible way of informing shareholders of our remuneration policies and would like to continue with this. This also corresponds to practice in the U.K. where such a report is a regulatory requirement. We hope, therefore, that the reference in para. 20 on page 6 of the Exposure Paper can be taken at its face value and that issuers will have flexibility in the manner in which these corporate governance disclosures are made - after all, the underlying objective is to ensure the provision of adequate and accurate information to shareholders, rather than dictate a precise format for the packaging of that information.

Q.3 Are there any ambiguities in the wording of the Provisions of the Code? If so, how could these ambiguities be clarified?

11. We have two general comments on the draft Code : -

(a) A decision needs to be taken as to whether requirements of the Companies Ordinance or of the Listing Rules are, or are not, to be included as Code Provisions. For example, the requirement to give 21 days' notice of general meetings, set out in para. E.13 as a Code Provision, is actually a legal requirement. However, the introduction to the Code, set out on page 7 of the Exposure Paper, states that issuers may deviate from the Code Provisions, provided they disclose any deviations, together with reasons. In the case of those Code Provisions which are, in whole or in part, also legal or Listing Rule requirements, this approach is inapplicable and the "comply or explain" concept which governs the Code Provisions is inappropriate.

(b) On a number of occasions, there appears to be an overlap between Code Provisions and Recommended Best Practices. Given that the consequences of allocation of any particular corporate governance practice to one category or the other are different, the draft needs to be reviewed to ensure that a

clearer line is drawn between the Code Provisions and the Recommended Best Practices. Examples of this include paras. A.5.1 and A.5.5 (in respect of ongoing professional development of directors), A.5.2 (a) and A.5.8 (non-executive directors' functions with regard to strategy and performance), C.2.1 and C.2.3 (directors' report to shareholders on their review of the effectiveness of internal controls), C.3.2 (b) and C.3.6 (a) (Audit Committee review on independent external auditors).

Code on Corporate Governance Practices

The following are comments on individual paragraphs of the Code : -

A.1.8 : This should apply to "material" conflicts of interest - there is no reason to require a board meeting to be held in circumstances where the substantial shareholder interest in a given matter exists, but is immaterial - provided that this is disclosed by the directors concerned, so that the other directors can properly assess its materiality.

A.2.7 : We doubt that meetings between a chairman and his non-executive directors need to be considered as a best practice - whether such meetings are required ought to be a matter for the decision of the chairman and the directors, having regard to the circumstances and characteristics of the company. For example, this might be particularly appropriate for a board which has a majority or at least a very strong representation of executive directors. Otherwise expressed, this is a practice which boards may or may not decide to adopt, but there is nothing about this which inherently qualifies it to be considered as best practice.

A.3.1 : The identities of independent non-executive directors are disclosed in the Corporate Governance Report. We can see no useful purpose being served by requiring this information to be given in "all corporate communications", including routine administrative communications with shareholders where the identity or categorization of individual directors on the board is of no materiality. The flexibility given by relating this requirement only to corporate communication that disclose directors' names is, in fact, limited given that Listing Rule 2.14 states that the name of each director must be included in a wide range of corporate documents. In any event, this matter is not sufficiently important to be treated as a Code Provision.

A.4.1 and
A.4.2 : The requirement for non-executive directors to be appointed for a specific term is not instantly reconcilable with the requirement that they should also be subject to retirement by rotation at least once every three years. We assume that the effect of these two Code Provisions, read together, is that the appointment for a specific term would be overridden by the obligation to retire by rotation, albeit with the possibility of re-election.

A.4.3 : We appreciate that the notion that lengthy service can be relevant to the determination of a non-executive director's independent reflects the views of the Higgs Report and that this is likely to be retained in the final version of the Code. We would simply note in passing that we see no evidence of a link between lengthy service and independence. If anything, length of service gives rise to stature on the board and a familiarity with a company's affairs which actually promotes the exercise of independent and informed judgment by a director.

B.1.1 : We do not think that it should be a Code Provision that the majority of the members of Remuneration Committee should be INEDS. Provided directors are not determining their own remuneration, there is no reason why a majority of the Remuneration Committee need be INEDS, as opposed to NED's generally (or, at the least, this could be regarded as a Recommended Best Practice rather than a Code Provision).

B.1.3 : The Code is too prescriptive with regard to the terms of reference of the Remuneration Committee. These terms of reference are included as Code Provisions. However, if they are to be categorised in this first tier of the Code, nothing beyond B.1.3 (a) is required. We are dealing here with powers delegated by the board to a committee and it should primarily be a matter for the board to decide the details of the delegated authority to be conferred on the Remuneration Committee. Protection against abuse is provided by retaining para. B.1.4, the effect of which is that shareholders will be able to review the Remuneration Committee's terms of reference. If they feel that a board (which is perhaps dominated by a controlling shareholder or executive directors) has unduly restricted the role of the Remuneration Committee, with its majority of independent non-executive directors, this will be a matter for comment and sanction by the shareholders.

B.1.7 : We do not think it is a Recommended Best Practice for issuers to disclose the remuneration payable to senior management. It is a practice which issuers might or might not choose to consider as a good practice. In particular, the need or utility of providing such information is unclear. The shareholders do not vote on senior management remuneration and are inadequately placed to exercise any meaningful judgment as to whether that remuneration is appropriate for an individual performing a particular management function. Moreover, determination of senior management remuneration is a matter for the Remuneration Committee and the board. The position is, of course, different with regard to the disclosure of executive director's remuneration - disclosure to shareholders is part of the disciplines necessary to avoid directors rewarding themselves unfairly at shareholder expense.

C.1.4 and
C.1.5 : There has been sufficient debate about the merits or otherwise of quarterly reporting, to render it unnecessary to revisit those arguments in this letter.

However, given that the debate on quarterly reporting is still ongoing and that there are clear differences of opinion and, for that matter, practice in other markets regarding its desirability, it seems premature to endorse quarterly reporting in the Code as a Recommended Best Practice.

C.2.1 : We take it that the annual review by the board can be delegated to the Audit Committee since review of internal controls is a core task of the Audit Committee. It would be helpful to include a Note to allow reviews to be conducted by the Audit Committee.

C.2.2(e): We are not sure what is envisaged by this Recommended Best Practice (which we admit we should have commented on in the earlier drafts). It would be difficult for listed issuers to ascertain how effective its public reporting processes are. For example, from the feedback form we sent out to 22,000 shareholders with CLP's Annual Report 2002, we received less than 50 replies. It is a matter for the shareholders and those who receive information about the listed issuers to form a view on the effectiveness of the public reporting processes.

C.3.2 : As with the Remuneration Committee, the Code is too prescriptive in setting out detailed terms of reference of the Audit Committee as Code Provisions. In respect of each of the sub-headings contained in para. C.3.2 it would have been sufficient merely to have preserved the first paragraph (without sub-paragraphs and the subsequent other paragraphs), leaving the board to determine the detailed terms of reference. Again, as with the Remuneration Committee, no disadvantage to shareholders results since, under C.3.3, the terms of reference of the Audit Committee are made available to shareholders for comment and sanction.

C.3.6 (c)(iv): We are not sure what is envisaged by this Recommended Best Practice. The compensation (which we take to mean salary and other remuneration) of the individuals who perform the audit is a matter for the auditors themselves. We have no knowledge of how much our audit partners and their staff earn and it is not our business to enquire into this. This is something for the auditors themselves to address and, if thought appropriate, to disclose.

D.1.3 : We doubt that disclosing the division of responsibility between the board and management to third parties affected by corporate decisions is actually a good practice. In CLP's case we have a detailed structure of delegation in the form of a "Company Management Authority Manual" which sets out the division of responsibilities and authorities as between the various organs of the company. We have previously considered making this information available to external parties, so that they would understand the extent and nature of division of responsibility and delegation of authority within CLP. We decided against this for two reasons : -

(a) We were concerned that third parties affected by corporate decisions would require us to justify and provide evidence that those decisions had indeed been made by the corporate organs or individuals properly empowered to do so by our internal authority arrangements; and

(b) We did not think that such disclosure was ultimately in the interests of the third parties themselves. In particular, the risk is that this will deny such third parties the benefit of the Rule in Turquand's Case, whereby in the absence of knowledge to the contrary, third parties are entitled to rely on the ostensible authority of those acting on behalf of the company to bind that company. This is perhaps something that the Exchange may want to review with its own legal advisors.

E.2.1 : On the basis that the procedures for demanding a poll are included in the notice of General Meeting, it should be unnecessary for the chairman of the meeting to provide an explanation of the detailed procedure at the meeting itself.

Corporate Governance Report

4(a) : The shareholdings of senior managers would not seem to be particularly important or relevant.

4(b) : In order to avoid the Corporate Governance Report becoming unduly lengthy, it is hoped that this disclosure could be given by cross-reference to this information being set out on a company's web-site, with hard copies being provided free of charge to shareholders on request. Generally, this point relates back to earlier comments regarding the non-prescriptive format of the Corporate Governance Report. Lengthy disclosure of routine information, which is unlikely to change from year to year, should be permitted to be disclosed by way of web-sites, provided that shareholders' rights to access and obtain that information are clearly mentioned in the Corporate Governance Report.

4(d) : These recommended disclosures of the review on internal control are extensive and onerous (this comment, like others in respect of the Recommended Best Practices under the Code and the recommended disclosures under the Corporate Governance Report, rest on the view that CLP, like most major issuers, will take these recommended practices extremely seriously and would be aiming to reduce any deviation to the minimum). It is suggested that it would be sufficient for the recommended disclosure to be limited to the wording set out in sub-paragraph (ee) accompanied by a description of the basis on which the directors concluded that the internal control systems were effective and adequate.

Provisions in the U.K. Combined Code not adopted in the draft Code

During the working group's review of the earlier draft of the Code, we had an opportunity to comment on the advantages of including provisions on the role of the company secretary, in line with those in the U.K. Combined Code. Our recollection is that, at one stage in the drafting process, those views, which were supported by some other members of the working group, had prevailed and appropriate provisions had been inserted. We are sorry that these have not survived. The reason for omitting such provisions, given at para. 9 on page 45 of the Exposure Paper, does not appear particularly convincing. The effective implementation of the enhanced corporate governance practices embodied in the Code and expressed in the Corporate Governance Report will require the input, advice and initiative of the company secretary. It would have greatly helped the company secretary's standing vis-à-vis the chairman and other directors, if the Code had included proper recognition of the company secretary's role. The failure to do this tends to weaken the authority of a company officer who can and should play a significant part in carrying forward the proposed Code and Corporate Governance Report to reality and full implementation.

Finally, although these comments necessarily focus on areas where we think the Code and Corporate Governance Report might be improved, or where the proposed requirements and recommendations have gone beyond that which is either necessary, or where these might infringe on a board's legitimate expectation of authority to determine the right way to govern its own affairs, CLP's underlying position is one of strong support for the objectives intended to be achieved by the Code and the Corporate Governance Report.

Yours faithfully,

P. W. Greenwood

Peter W. Greenwood
Director & Company Secretary

(S5299)