November 17, 1997

Corporate Governance --

The Business Roundtable Issues Its Statement

and CalPERS Plans to Survey Corporations

To advance an important area in which other organizations have previously taken positions**Footnote1**, on September 10, 1997, the Business Roundtable (BRT) issued a revised statement on corporate governance which addressed three areas: (1) functions of the board, (2) structure and operations of the board, and (3) stockholder meetings. This statement addresses many of the same issues found in the California Public Employees' Retirement System (CalPERS) June 1997 draft memorandum to its board on proposed corporate governance principles, but BRT's position on some issues is quite different.

The BRT document presents some specific and useful views on the importance of director independence and proper board operation, while cautioning that companies should not follow form over substance. If CalPERS' plans as outlined in its draft memo are carried out, it will send surveys out to the largest 300 - 500 U.S. companies in which it holds investments. Because the two-to-three month expected timeframe for responses may not be long enough for companies to prepare a thoughtful response, companies should review the draft today and begin to craft their responses on how their policies reflect the proposed principles.Footnote2

The Investment Committee of CalPERS issued its draft memorandum to recommend that their Board of Directors adopt certain corporate governance principles for U.S. companies. These principles were developed in response to requests from many companies who were previously surveyed by CalPERS on corporate governance issues. These companies asked for guidance as to CalPERS' position on certain fundamental corporate governance issues.

The CalPERS' draft proposal addresses three main topics: (1) board independence and leadership, (2) board processes and evaluation, and (3) individual director characteristics. For each of the topics, CalPERS has developed *fundamental* criteria which it believes need to be in place today, and its view of the *ideal* criteria which it thinks all companies should move towards in the future. These are listed on the **Attachment.**

Both CalPERS and BRT believe that companies which have good corporate governance policies in place will be able to respond more quickly and effectively to situations that affect the health of the business and, thus, shareholder value, such as changes in leadership and business downturns. In its introductory statement, BRT also takes the position that there should not be a conflict between the interests of shareholders and other stakeholders. While BRT states that "the paramount duty of directors is to the corporation’s stockholders" it is also in the long-term interests of those stockholders for the corporation to treat its other stakeholders fairly.

The BRT position is outlined below, is compared to the CalPERS’ draft position, and is followed in some cases by our comments:

1. FUNCTIONS OF THE BOARD

Management Selection and Compensation

BRT: The selection and evaluation of the corporation’s CEO and top management is the board’s most important function. The CEO’s performance should be reviewed annually in an executive session of outside directors. The Board is responsible for ensuring that compensation plans are appropriate and competitive, support the business and include stock compensation as a link to shareholders.

CalPERS: Their policy is more specific in stating that there should be an annual presentation on succession planning, that the compensation committee should have access to an independent advisor and that the CEO’s compensation be compared to that of peer company CEOs and have a substantial portion at risk.

FWC: We support a periodic review of succession planning, annual CEO evaluations and significant pay at risk for senior management. Our view of peer pay comparisons is that they are most useful when peer performance is also factored in, and that these comparisons, as with any survey data, should not be the primary drivers of the program.

Approval of Major Strategies and Financial Objectives

BRT: Approving major strategies and financial objectives is also a key board role. The company’s objectives and results should be evaluated in the context of the company’s wider business strategy, and the board should begin more intensive oversight when results are significantly short of the goals.

CalPERS: Not directly addressed

Advising Management

BRT: An effective board member will provide advice and counsel to the CEO and other members of management both through the formal meeting process and through informal contacts.

CalPERS: All directors should have access to senior management with the CEO or lead director as liaison.

FWC: While we agree that advice can be given informally, all major issues should be brought before the whole committee or board.

Risk Management, Controls and Compliance

BRT: The Board must ensure that a system of controls is in place for managing the company's assets, risk and regulatory filings and should review reports from experts, such as auditors, in this process.

CalPERS: Not directly addressed

Selection of Board Candidates

BRT: The board is responsible for nominating directors and should present a diverse slate of individuals who are highly experienced in their own fields, will represent the interests of all shareholders and will devote the necessary time and attention to the role. Inside directors should consult with their own boards before accepting outside directorships. There should be a policy for considering stockholder suggestions for board nominees.

CalPERS: Specific competencies are recommended for directors, such as experience with accounting and finance, international markets, etc. Directorships should be limited to three boards outside a director's own company board.

FWC: Presumably CalPERS would not expect a single director to have all the competencies, but for the board in total to have them. We only support limitations on board membership in cases where the prospective board member clearly could not give the necessary time. We do think that a company's board should review and approve outside board membership for the company's senior officers to ensure that they are compatible with the company's best interests.

Board Evaluation

BRT: The board should periodically evaluate its structure, governing principles and performance, but does not need to establish a schedule for doing so.

CalPERS: The board should establish a corporate governance committee which will develop its corporate governance principles and review them every two-to-three years. Individual directors should be evaluated periodically on pre-established criteria, such as attendance and participation.

FWC: We favor periodic reviews of a board's and individual director's performance, but do not think that a separate corporate governance committee is necessary.

2. STRUCTURE AND OPERATIONS OF THE BOARD

Board Composition

BRT: Their view is that smaller boards are generally more effective than larger boards. They also recommend that a majority of board members be outside directors to ensure independence, but strongly emphasize that simply putting this rule in place does not ensure independence and may preclude a valuable contribution from a person who would not meet the criterion of unaffiliated independent director. They recognize that compliance with some regulations, such as IRC §162(m), require rigidly defined independent directors. They think that, in most cases, the company is best served if the CEO is also chairman. Boards should plan for their own succession and may have guidelines for resignation, such as age or change in position, but do not need mandated term limits.

CalPERS: CalPERS' view is that the CEO should be the only employee on the board and should not be the Chairman, that at least 80% of the board be independent, that certain committees, such as the audit committee, should only have independent directors, and the independent board members should meet alone at least once a year. There should be term limits for directors and no more than 10% of directors should be over 70.

FWC: We agree with BRT that independence is often more a function of personality than relationship and would not set a limit on the number of affiliated directors. We agree that the board should periodically meet in executive session and would include affiliated directors in those sessions. We support a policy which requires directors to submit their resignations when they reach a certain age, e.g., 72, or when their occupation changes, but the board should have the option of asking these directors to stay on if they are making a strong contribution.

Committee Structure

BRT: They recommend having audit, compensation/personnel and nominating/ governance committees, but caution against having too many other standing committees because they think it is important for the whole board to be involved in important decisions. They outline the basic responsibilities of the three core committees and recommend ad hoc committees to address special issues. In addition to the responsibilities of the compensation committee discussed earlier, BRT recommends that the committee report to the full board on CEO compensation and does not think that CEOs who serve on each others' boards should serve on the compensation committee.

CalPERS: Summarized earlier with the BRT view on Management Selection and Compensation.

FWC: We agree that the compensation committee should at least report to the full board on the CEO's compensation; preferably the committee would ask for full board approval on this very sensitive issue.

Board Compensation

BRT: Board compensation should be competitive and appropriate for the type of directors the company wants to attract. This means that many different types of compensation could be considered, including retirement plans. Equity compensation should be included in all programs.

CalPERS: Directors should receive only cash and stock. The directors' program should be reviewed for competitiveness at least once every three years.

FWC: We support the CalPERS' position that directors should not receive pensions.

They should, however, be able to defer their cash and stock compensation until they retire from the board.

Operations

BRT: The frequency of meetings should be determined by the complexity and needs of the business. The outside board members should have an opportunity to meet in executive session at least once a year. Agendas are typically prepared by the CEO, who should periodically check with the directors for their evaluations of the agenda. Board members should receive information on the agenda items in advance of the meeting and have access to senior management and information about the company as needed. The board, generally with the knowledge of the CEO, should have access to independent experts. Communication to the outside world is the responsibility of management. The board should at least discuss its corporate governance practices whether or not it develops a formal written policy.

CalPERS: The outside board members should meet at least once a year in executive session. There should be a written corporate governance policy which is reviewed every two years. Board members should have access to senior management and there should be a formal program for communication between directors and shareholders.

FWC: We agree with both organizations that outside board members should meet in executive session; this session should be available at every meeting. We think that communication should be coordinated by the company, but directors should certainly be available to speak to shareholders or the press. We support formal written corporate governance policies as a means for promoting communication and clarity between directors, shareholders and the company.

3. STOCKHOLDER MEETINGS

Agendas and conduct of the Meeting

BRT: A written agenda and principal rules for the conduct of the meeting should be made available to all attendees.

CalPERS: Not specifically addressed

FWC: We support the BRT position.

Management and Stockholder Proposals

BRT: The consideration of management and stockholder proposals should be conducted through the proxy process rather than through proposals raised at stockholder meetings so that all shareholders have an opportunity to review the issues. Only matters of significance to a broad group of shareholders should be brought to shareholders. Advance notice of any issues to be presented should be mandated by the company's by-laws. And, finally, the company should have an adequate system to tabulate the votes in a timely and reliable manner.

CalPERS: A fairly extensive list of specific shareholder rights is presented, including the ability to call special meetings and the right to approve poison pills. They believe that all proxies should be confidentially voted unless shareholders wish to be identified.

FWC: We support the BRT position that an orderly proxy process should be followed, and all shareholders should have an opportunity to review issues brought to the meetings. In the interest of good communication between a company and its shareholders, we think votes should not be confidential.

We applaud CalPERS' efforts to communicate its views on corporate governance to the companies in which it invests. We are, however, concerned that many companies will simply adopt them without consideration for their own special situations. We are, in general, more supportive of BRT's approach which puts more emphasis on the individual company's situation and provides for a broader range of acceptable policies.

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General questions on this letter may be addressed to Beverly Aisenbrey in the New York Office (212) 986-6330. Copies of this letter and other published materials are available on our web site, WWW.FREDERICWCOOK.COM.

Attachment

11/17/97

CalPERS' Draft Principles

of Corporate Governance

A. Board Independence and Leadership

Fundamental	Ideal
1a. A *majority* of the board consists of directors who are independent. **1b**. Independent directors meet periodically (at least once a year) alone, without the CEO or other non-independent directors.	**1.** The CEO is the only company employee who is a director. In addition, non-independent directors (beyond the CEO) comprise no more than 20% of the board.
2. When the chair of the board also serves as the company's chief executive officer, the board designates an independent director who acts in a *lead capacity* to coordinate the other independent directors.	**2.** The *chair* of the board is an independent director.
3. Certain board committees consist *entirely* of independent directors. These include the committees who perform the following functions: • Audit • Director Nomination • Board Evaluation & Governance • CEO Evaluation and Management Compensation • Compliance and Ethics	**3.** The chairs of these independent-only committees have access to advisers and other experts who are independent of management.
4. *Director compensation* is a combination of *cash and stock* in the company. The stock component is a significant portion of the total compensation. Directors receive *no other form of compensation* (e.g., retirement benefits). The board reviews director compensation, at least once every three years, against the compensation of directors of comparable companies.	**4a.** *At least 50%* of the director's total compensation is in the form of company stock. **4b**. No director may also serve as a consultant or service provider to the company.

B. Board Processes and Evaluation

Fundamental	**Ideal**
1. The board has adopted a written statement of its own *governance principles* and re-evaluates these principles at least every two to three years.	
2. The board has charged a specific committee, consisting entirely of independent directors, with the responsibility for recommending governance principles.	
3. With each director nomination recommendation, the board considers the *mix of director characteristics, experiences and skills* that is most appropriate for the company. Minimally, these *core competencies* address: • Accounting or finance • International markets • Business or management experience • Industry knowledge • Customer-base experience or perspective • Crisis response • Leadership or strategic planning	
4. The board establishes *performance criteria* for itself (acting as a collective body), and *individual behavioral expectations* for its directors. Minimally, these criteria address the level of director: • attendance • preparedness • participation , and • candor	**4.** To be re-nominated, directors must satisfactorily perform based on the established criteria. Re-nomination on any other basis is neither expected nor guaranteed.
5. The independent directors establish *performance criteria and compensation incentives for the CEO*. The independent directors have access to *advisers* on this subject, who are independent of	

Fundamental	**Ideal**
management. Minimally, the criteria ensure that the CEO's interests are aligned with the long-term interests of shareholders, that the CEO is evaluated against comparable peer groups, and that a significant portion of the CEO's total compensation is at risk.	
6. The board has in place an *effective CEO succession plan*, and receives at least annually reports from management on the development of senior management.	
7. All directors have *access to senior management*. However, the CEO, chair, or independent lead director may be designated as liaison between management and directors to ensure that the role between board oversight and management operations is respected.	**7.** The board has a formal program (beyond the annual meeting) for *communication and dialogue between directors and shareholders*.

C. Individual Director Characteristics

Fundamental	**Ideal**
1. The board has adopted guidelines that address the *competing time commitments* that are faced when director candidates serve on multiple boards. These guidelines are published annually in the company's proxy statement.	**1a.** Generally, no director candidate may sit on more than *three boards* other than the company's board (whether the other board is of a public company, private company, or non-profit organization), although board may consider individual variations to this limit where the actual time commitment warrants an exception.
	1b. A company's *retiring CEO* may not continue to serve as a director on the board.
2. No director is considered an independent director after having served *10 or more years* on the company's board.	**2.** The board has adopted guidelines limiting the length of time in which a director may serve on the board. These *term limit guidelines* are published annually in the company's proxy statement. The proxy statement expressly

Fundamental	Ideal
	identifies any director candidate who exceeds these guidelines.
3. The board has adopted an *age range criterion* for its directors.	**3.** No more than 10% of the directors are over the *age of 70*.

D. Shareholder Rights

Ideal

A majority of shareholders may amend the company's by-laws by shareholder proposal.

A majority of shareholders may call special meetings.

A majority of shareholders may act by written consent.

The company prohibits the payment of greenmail.

The board may not enact nor amend a poison pill except with shareholder approval.

All directors are elected by the shareholders annually.

Proxies are kept confidential from the company, except at the express request of shareholders.

Broker non-votes are counted for quorum purposes only.

Any shareholder proposal that is approved by a majority of proxies cast is either implemented by the board, or the next annual proxy statement contains a detailed explanation of the board's reasons for not implementing.

Shareholders have effective access to the director nomination process.

Footnote1

Both TIAA-CREF (see our letter of March 23, 1994) and the Toronto Stock Exchange have previously published their corporate governance principles and the American Society of Corporate Secretaries issued a discussion document on corporate governance issues. BRT initially issued a statement in 1990.

Footnote2

CalPERS cautions that this document is still in draft form, so there may be substantial changes before it is adopted, which is now not expected to occur before February 1998. Our view is that they may not adopt the sections which require term limits and allow no more than 10% of directors over age 70.