THE CORPORATE GOVERNANCE ALLIANCE DIGEST SPECIAL EDITION

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As a service of Eleanor Bloxham and John M. Nash, below are complimentary summaries of up to date news, information and perspectives on issues in value and corporate governance.

THE CORPORATE GOVERNANCE ALLIANCE DIGEST: SPECIAL EDITION: CORPORATE GOVERNANCE REFORM

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Published by: Eleanor Bloxham and John M. Nash (John M. Nash is the founder and President Emeritus of the National Association of Corporate Directors. Eleanor Bloxham is the founder and President of The Value Alliance and author of "Value-led Organizations" and "Economic Value Management" (both John Wiley and Sons). They work with CEOs and Boards to implement powerful, straightforward processes that answer the critical questions that must be addressed to improve oversight and add value.

A little over one year ago, WorldCom announced that an internal auditor at the firm (Cynthia Cooper) had uncovered accounting irregularities. As part of a settlement of the fraud complaint filed by the S.E.C., WorldCom was required to adopt all of the court appointed monitor (Richard Breeden) recommendations or obtain an exemption from the US District Court (Judge Rakoff) for any it could not accept.

WorldCom (MCI) directors and CEO Capellas have approved the entire set of governance guidelines. They are extensive and they are worthy of attention by readers of this Digest. The 150 pages of guidelines are summarized below.

HIGHLIGHTS AND ANALYSIS by Eleanor Bloxham

These recommendations, while in large measure very worthwhile, should not be implemented as a checklist.

Here are ones of particular interest.

- Emphasis on disclosure including invitation for comment from shareholders and others on the level of financial transparency and risk assessment – involving both the Audit and Governance Committees.
- Shareholder nominations to the board using a Committee concept.
- One-year terms; one director each year not standing for reelection.
- Board service limitation of 10 years. Other for-profit board limits: maximum service on 2 other for-profit boards (CEO: no other for-profit boards).
- A nonexecutive Chair with specific duties and responsibilities outlined with annual election by board secret ballot and performance review by the Governance Committee.
- Mandatory external auditor rotation.
- A website where shareholders (one or more) representing 1% of the voting power can submit resolutions for a vote by all shareholders with those that receive a vote of some threshold (say 20% or more) placed on the company's next proxy statement.

Here are ones that should be particularly scrutinized because of potential conflicts or other issues and consequences.

- External auditor tax advice/services permitted.
- Internal audit reporting administratively to the CFO.
- Stock ownership requirements for Directors and managers.
- Identification of performance measures tied to economic value.
- Projecting dividend expectations to shareholders.

THE RECOMMENDATIONS

The recommendations that have been adopted are outlined below.

1. BOARD SIZE AND QUALIFICATION FOR MEMBERSHIP

a. A board size of 8 to 12, with a target of 10, led by a nonexecutive Chair who sets agendas, coordinates committee work, distributes information, coordinates site visits, reviews ethics, internal audit and legal compliance effectiveness, oversees board and CEO evaluation, and presides at meetings. The nonexecutive Chair should have staff resources selected by and accountable to the Chair.

b. ALL independent other than the CEO. (SEE NOTE 1)

c. The CEO may NOT serve on any public or private for-profit boards. Other directors may not serve on more than 2 other boards, except for full time CEOs (or other senior officers) who should only serve on their own board and this board. (Retired CEOs are preferred to full time CEOs as board members to prevent conflicts and interlocks.)

d. Each director to provide an identifiable skill as minimum qualification and meet other qualification requirements on an ongoing basis as well. Special qualifications for nonexecutive chair. (SEE NOTE 2)

e. Each new director must complete a course of intro to the company. All directors annually must complete refresher training on accounting, disclosure, governance, compensation and/or other industry developments.

f. One-year director terms. No director may serve for more than 10 years or past age 75. No nonexecutive Chair may serve in the chair capacity longer than 6 years.

g. Board members must tender their resignation should their status change; such resignation to be accepted or rejected by the board.

2. BOARD EVALUATIONS AND ELECTIONS

a. Each year the Board to conduct a peer review of Director performance, a performance review of the nonexecutive Chair, and a nomination and election of the nonexecutive Chair by secret ballot.

b. Nominees for election should be solicited from the largest shareholders representing at least 15% of outstanding shares (to encompass at least 10 of the largest shareholders). This "Shareholder Committee" is to meet with the Governance Committee to agree on candidates. If no agreement is reached, the Shareholder Committee is entitled to one nominee for each vacancy in that year to be included as part of the management proxy.

c. Each year a new director is elected who was not, in the last 5 years, an employee or director. Unless there is a vacancy, this means each year one member does stand for reelection. This is to be based on particular criteria or chosen by lot but may not include the CEO or any shareholder nominated director (within 3 years of election).

3. NUMBER OF MEETINGS

a. Minimum of 8 meetings (ideally 10) including one board strategic retreat of not less than 2 days that includes a "state of the company" report from the CEO and a review by the board of the company's disclosure program. Minimum of 2 meetings (ideally 2 – 3) at company facilities other than headquarters. At least 1 visit by individual directors to company facilities separate from meetings. Short special purpose phone calls not counted as meetings for this purpose.

b. Independent directors meet at each meeting without the CEO or other management members present.

4. BOARD AND CEO COMPENSATION

a. Nonexecutive Chair's compensation not to exceed 2x the annual board retainer, which should be set at not less than $150,000 per year. Audit committee members to receive an additional retainer of at least $50,000 with the chair receiving at least $75,000. Governance, compensation, or risk management committee members to receive an additional retainer of at least $35,000 with the chairs receiving at least $50,000. Meeting fees should not be paid.

b. All directors comp in cash only; however, directors should buy common stock each year at full market prices equal to at least 25% of cash compensation received. The stock purchased related to this requirement should be held not less than 6 months following termination as director except in the case of death or disability.

c. Any purchase/sale of stock by directors or senior officers should be disclosed to the market by company press release not less than 2 nor more than 14 days before the transaction. "Window policies" should be established and disclosed. Derivative transactions should be prohibited.

d. Not less than 50% and ideally 60-75% of total CEO comp should be paid in cash. The remainder should be in restricted stock subject to at least a 4 year holding requirement with not less than 75% held until at least 6 months following termination of employment, other than hardships. The board should set mandatory levels of stock ownership for different levels of management. Pay programs (in amount or vesting) should be based on serious corporate performance measures. (SEE NOTE 3)

e. There should be no executive retention payments except in specialized circumstances related to acquisition, disposal, closing or other events where the board may establish a limited program.

f. No employee should receive more than $15 mil in comp without shareholder approval. Maximum severance payable to any employee without shareholder approval are $10 mil for the CEO and $5 mil for other employees. (Terminations for poor performance should at least halve these amounts.) Shareholders should approve any adjustments to these maximums, which should come up for review every 5 years.

g. Compensation consultants should be independent and retained by the Comp Committee and should provide their view of the LOWEST reasonable level for awards. Board members should eye benchmark data warily.

h. No stock options to be awarded for a minimum 5 years following emergence from bankruptcy. Unless prohibited by GAAP, any granted stock options should be expensed.

i. Employment contracts/agreements should have duration of no more than 3 years.

j. Personal use of company aircraft should be prohibited.

5. THE AUDIT COMMITTEE

a. The audit committee composed of at least 3 independent members with specific qualifications related to financial expertise and prior audit committee experience. The board should elect the chair annually and the chair position should rotate at least every three years. Specific annual training requirements for members should also be identified.

b. Meet at least 8x per year with 6 being formal meetings. At least 1 meeting devoted to enhancing public disclosures. The audit committee chair should meet with internal financial personnel, external audit personnel, analysts and shareholders, and experts for the Committee.

c. The Committee should provide continuous review and oversight of internal audit, accounting and finance functions. The Committee should regularly review and approve internal audit's plan of work, risk assessments, staffing levels and overall competence, and be responsible for insuring the independence, competence and experience of the department. Internal audit should report administratively to the CFO for budget, staffing, promotion and training purpose and be located at company headquarters.

d. At least 2x per year, the Committee should review efforts by management and outside auditors to enhance internal controls and risk management and with General Counsel and the Ethics Office to assess legal and regulatory risks and compliance with related party transaction requirements.

e. At least 1x per year, the Committee should review usage of corporate aircraft, the performance of the CFO to ensure no conflicts of interest and assess the CFO's record in achieving transparency, training and recruiting finance staff, and meet with shareholders, analysts and outside observers to obtain input on the quality of disclosure with the objective of maximum transparency.

f. Regularly, the Committee should meet with external auditors to review the annual audit plan, testing of internal controls, their letters, and accounting policy issues – and review their invoices before payment. The performance and independence of the external auditors should be actively reviewed. Consulting by them should not be permitted (except tax work done solely for the Company). Maximum external auditor engagement of 10 years with solicitation of audit proposals at least every 5 years.

g. Independent legal and analytic resources should be identified and retained by the committee so that they can be consulted as necessary.

6. GOVERNANCE COMMITTEE

a. The Governance Committee to be composed of at least 3 independent members. The board should elect the chair annually. Members should have significant experience in governance issues.

b. Meet at least 4x per year.

c. Responsible for all nominations (board and committee), recommending board comp levels or changes in committee responsibilities to shareholders, overseeing all amendments to articles, by-laws, guidelines, assisting the nonexecutive chair with evaluations of the board, CEO and CFO and evaluating the nonexec chair's performance annually.

d. Establish a website to offer shareholders a town meeting forum for discussion. Shareholders (one or more) representing at least 1% voting power would be able to place resolutions for consideration by all shareholders and those that meet a threshold (say 20%) would be included on the next proxy statement.

e. Working with the Audit Committee, establish and oversee a Disclosure Committee of management, directors and external advisors that should consider the quality of company disclosure, ways to improve transparency and verify compliance with ethics.

7. COMPENSATION COMMITTEE

a. The Compensation Committee to be composed of at least 3 independent members. The board should elect the chair annually and the position should rotate every 3 years. Members should have experience in compensation and human resource issues. Specific annual training requirements for members should also be identified.

b. Meet at least 4x per year. Chair should meet regularly with internal human resource personnel, external advisors, analysts, shareholders, advisors to the Committee and others. At least 2x per year meet with the Director of HR and General Counsel to review related party transactions, HR and comp complaints, disputes and issues and compliance with SEC proxy disclosure.

c. At least annually formal review of performance of the director of HR.

d. Independent professional and analytic advisors should be identified and retained by the committee so that they can be consulted as necessary.

e. Directly retain all compensation consultants that advise the committee and actively review their performance and independence.

8. RISK MANAGEMENT COMMITTEE

a. The Risk Management Committee to be composed of at least 3 independent members. The board should elect the chair annually. Members should have experience in the identification, evaluation and control of risk and one member with significant industry experience.

b. Meet at least 6x per year. Review company risk disclosures and work with outside advisors to review the id of risks and plans for risk control, mitigation, and disclosure. Consult with major shareholders from time to time.

9. OTHER RECOMMENDATIONS

a. Enhanced cash flow reporting.

b. Establish and publish a dividend policy (setting an initial target of at least 25% of net income) and informing shareholders of target payouts.

c. Standards of disclosure: what the CEO, CFO or outside auditor would want to know if they were investing.

d. Avoid projecting earnings.

e. Intensify efforts to recruit senior level finance, accounting and internal audit personnel.

f. Establish a formal ethics office under the leadership of the CEO and General Counsel and review all programs thoroughly and at least annually. Include ethics pledge in training.

g. Ensure a strong legal department and hold meetings with General Counsel at least annually without any other management present to discuss resources, adequacy of compliance and ethics programs and contingent legal risks.

h. Reject poison pills, staggered boards and related measures to the degree possible.

i. Review diversity practices, and recruitment, training and advancement of women and minorities.

NOTE 1

Audit Committee independence includes no comp, indirect or direct payments from any 1% or greater shareholder. More generally, independence rules cover company employment (including close blood or marital relation) and consulting/professional service relationships, interlocking board relationships, nonprofit and political donations and personal/commercial business relationships with the CEO.

NOTE 2

Qualification standards cover fiduciary duties of care and loyalty, independence, 75% of members with a minimum number of years of experience (say 3) serving on the board of directors of a publicly traded company with a minimum threshold of market capitalization, revenue or assets, no significant prior personal or financial ties with the CEO, limited number of boards serving on, no conflict of interest, no government proceeding or court decision finding violatation of fiduciary duties. Each director should provide an identifiable skill such as financial, accounting, industry, technology, marketing, strategy and planning, major company senior management or federal, state government or regulatory experience. Nonexec chair qualifications include additional limits on company employment and additional experience requirements.

NOTE 3

Noted in the recommendations are: profitability, tangible net worth, strength of balance sheet ratios, return on assets or equity, growth in net income or EBITDA, cost reductions, growth in market share or "other hurdles that reflect the creation of real economic value."

WHAT ARE YOUR THOUGHTS ON THE RECOMMENDATIONS? Please write and we will share your comments (confidentially) in our next edition of the Digest. Write to ebloxham@thevaluealliance.com