

1 MR. McCALLUM: : Thank you, we appreciate it.

2 THE WITNESS: Yes, sir.

3 MR. CHEEK: Thank you. You may have heard we
4 have received your written testimony so you can assume
5 that we have reviewed those comments and be glad to
6 discuss those with you or listen to anything you would
7 like to add to that.

8 THE WITNESS: I'm happy to discuss them. I
9 think discussion might be more valuable than argument.

10 MR. CHEEK: Could you talk about your proxy
11 access at this point?

12 THE WITNESS: Sure. In the written testimony
13 we talk about two areas what we think there is a need
14 for improved shareholder access to the issue of proxy.
15 The first is by far more important of the two. As I
16 think you all are well aware, under current law, both
17 state and federal securities law, investors have no
18 right of access to the issue of proxy for director
19 candidates. This is an extraordinarily important fact
20 about corporate governance today because what that
21 means is that should a shrewd investor, institutional
22 or otherwise, wish to nominate their own candidate for
23 the board, they have to incur significant cost. For
24 large cap company the printing and mailing costs alone
25 for a complete shareholder solicitation will typically

1 run over a million dollars. In addition to that you
2 have to go through the complete SEC clearance process
3 for your own proxy. These cost are frankly
4 prohibitive in almost all situations, particularly to
5 institutional investors who are under a risk or other
6 duties. The collective action problem is an economic
7 matter. It cannot be surmounted. What that means is
8 that investors who are unhappy with the composition or
9 action of the board really have two possible ways of
10 dealing with it. One is through essentially
11 persuasion which in essence most shareholder proposals
12 are. Except the most aggressive form of persuasion
13 obviously is you can call the management, call the
14 board, talk to them. If that doesn't work the next
15 step really moves into areas that are far, far more
16 aggressive in litigation. And it's instructive that
17 when the counsel of institutional investors met with
18 the chancellor and vice-chancellor of the Delaware
19 Chancelory Court last spring, the entire discussion
20 for two hours kept moving from the shareholder process
21 is inadequate, what litigation remedy can you give us,
22 this was the question for the chancellors. Their
23 response always was at the end of the day. We think
24 you ought to be going to the director of elections is
25 the solution. The problem is the director of

1 elections is economically untenable in most instances.
2 Our proposals because of it in response to that is to
3 create and act as provider to the proxy, only in a
4 very delimited form. Because we don't believe that
5 the right of access to the proxy should either be
6 available, bluntly, to all shareholders in the way the
7 shareholder proposal rule is. Nor do we believe that
8 ought to be everybody who doesn't pay for a takeover
9 fight for free. Therefore we think it ought to be two
10 things. One is locked up with fairly substantial
11 threshold for getting access to the proxy. At least 5
12 percent of the total shareholders and we believe also
13 in addition there ought to be perhaps a numerosity and
14 a tenure requirement associated with that.

15 And then secondly there ought to be access
16 for a short slate, and a short slate only. There's
17 got to be a way to figure that out through the
18 classified board's structure as well. That's our
19 first and in our opinion the most important
20 proposition here as my testimony indicates. We
21 believe that if the overall reform process now
22 underway in so many different venues does not
23 ultimately give shareholders some more -- greater
24 ability to influence who the directors are that the
25 closed nature of the CEO, the board relationship may

1 not lend itself to solving some of the problems that
2 have been identified in the last year.

3 Secondly, with respect to shareholder
4 proposals, we have a somewhat similar proposal which
5 is that we ought to have a way of having the
6 shareholder proposal process respond more flexibly to
7 changing circumstances. Right now the ordinary
8 business rule which the SEC administers and we believe
9 in the end, in general in this experiment, it is
10 insufficiently flexible to deal with for example, in
11 the last year, the sudden appearance of issues like
12 auditor independence, as critical corporate governance
13 issue. If you create an override which allows a
14 certain percentage of the company's investors who
15 believe that the proposal really constitute something
16 that the shareholder ought to vote on, to get through
17 it to overwrite the ordinary business rule. We think
18 that would again facilitate greater flexibility in the
19 corporate governance position. That's a long answer
20 but I hope that that gave you what you need.

21 MR. CHEEK: Do you see any opportunity for
22 improved governance in connection with the nomination
23 process through a more stringent environment of
24 independence on nominating committees and using the
25 board oversight function to facilitate assurance that

1 it's not a -- always a management directed process.

2 THE WITNESS: Well, as I indicated in our
3 testimony, we feel that the task force's
4 recommendation in this area of having the nomination
5 of independent directors should be done by independent
6 nominating committee. It's a positive thing. It
7 should be quite helpful, and we support it. However
8 we don't believe it's sufficient and the reason for
9 that is because our experience in dealing with sort
10 of, the bad APRIL will so to speak, in this area which
11 I'm not -- by that I don't mean companies where
12 there's been fraud or theft. I mean companies that
13 have been responsive to shareholder concerns. Is
14 that, is it generally possible for a CEO in a closed
15 loop with their board to subvert these independent
16 processes. These processes are good. We favored
17 strengthening them. We think that this particular
18 mechanism that this board came up with is a very
19 creative and important one. But the CEO that wishes
20 to do so can ensure that the normalty independence of
21 people on their board are in fact psychologically
22 devoted to them. That needs to be a back stop to that
23 process. That's what I was just discussing a moment
24 ago.

25 MR. KELLER: There're couple of things. I

1 need -- I see your proposal on the record of
2 nomination as really focussing on the ability for the
3 groups to obtain recommendation as opposed to
4 addressing the entire makeup of the board. You could
5 end up with kind of different segments doing it with
6 your short slate proposal.

7 THE WITNESS: No, I mean I respectfully
8 disagree. I mean I don't think we --

9 MR. KELLER: Correct me.

10 THE WITNESS: Yeah, if we were suggesting
11 that every ten percent, each ten percent of the
12 shareholders, it's in the record; right? That would
13 certainly be, I think susceptible to the criticism
14 that you are talking about balkanizing the board. We
15 view this proposal, the nature of this proposal is
16 that A, it's designed to insure that a small faction
17 within the shareholder community simply cannot get
18 access to it. In most public companies of any size, a
19 5 or 10 percent threshold could do something involves
20 recruiting a number of large investors with a general
21 investor perspective, put it that way, and we would be
22 open to any modifications to this proposal this would
23 ensure this further.

24 But then secondly, of course, these people
25 have to win. Then the only way they can win is to get

1 a majority. In this case they would be getting
2 majority facing the opposition of management. I think
3 those are sufficient safeguards to ensure this doesn't
4 become a vehicle for, as I said, for balkanizing the
5 board. What its purpose is, as I said before, is to
6 give a back stop, a back stop for situations which
7 management is simply unresponsive and to create an
8 environment in which, hopefully, it would be very,
9 very rarely used.

10 The fundamental problem with the
11 institutional investor community faces right now, and
12 has faced during the years, the last ten years and so
13 forth, the governance activism it is that the
14 management with the support of its board simply wants
15 to it back up there isn't much recourse beyond very,
16 very severe measures like litigation and tender
17 offers. And this is dilemma that need intermediate
18 steps that would hopefully facilitate never have --
19 rarely needed to be used.

20 MR. KELLER: Sir, I remember now I recognize
21 you having participated in that conversation you
22 referred to with the vice chancellors, and
23 in that same conversation there was a point made by
24 someone, if you could address that, was the question
25 of where these candidates you were envisioning

1 emerging from this process, where did it come from?
2 There was a concern expressed, as I recall it, that
3 the institutional investigation talked about are
4 reluctant to name candidates so where is the evidence
5 that, in fact, there is a block supply of candidates?

6 THE WITNESS: That's a very important
7 question. And I think it's important to differentiate
8 amongst the different institutional investors. This
9 is what I mean by that in that conversation, I think
10 someone I forget whom amongst the vice-chancellor says
11 about --

12 MR. KELLER: What are you --

13 THE WITNESS: Yeah, yeah, it would be him.
14 Why, you all say you want a better group of boards of
15 directors but you won't serve yourselves. That's
16 essentially his point. And there's a sort of a
17 problem which I think might be widely agreed upon as
18 the result of the problem of this, with the officials
19 of public pension funds serving on the boards of
20 private corporation while they're in office as public
21 servants. There's a tension there, that while people
22 might disagree exactly what the problem is but I think
23 they might be wise to recommend that --

24 MR. KELLER: That raises some concerns.

25 THE WITNESS: And so I think there is a

1 reluctance on the part of, say, members of the board
2 of CALPERS, or CALPERS' CEO served on a board on a
3 public company. However, there should be no
4 reluctance on the part of money managers or on the
5 part of institution that are sort of a little unclear
6 how they would want to be characterize themselves. In
7 addition, and by the way, we have encouraged money
8 managers to make, to have their people available to
9 serve on the boards of companies they invest in, so
10 long as they understand two things. One is that
11 they're there on behalf of all the shareholders, not
12 just the fraction they represent. And two, they
13 understand they are not there as a personal perk.
14 That's a issue that arose with Alliance Capital in the
15 subject of Enron, where Alliance said these people on
16 those boards. It's their private business. That's
17 inappropriate.

18 But Alliance said to us we'd like to not have
19 anyone sit on the board at all, and we said no, we
20 don't want you to do that. We want you to have the
21 people on that taken seriously. But beyond that,
22 though, I think that there is a need and it's an
23 addressable need, to recruit a larger pool of
24 independent directors. And that -- one can use the
25 management sources that when we would go to Covad,

1 academia and Wall Street, retired individuals from the
2 business community, and we together with some public
3 pension funds are actively engaged in that process
4 right now in an effort to try to respond to some
5 deadlocks that are occurring under the current rules
6 we're not sure we'll be successful. But whether these
7 collective action problems will prevent us from doing
8 so but we're not waiting for the reform we think we
9 need.

10 MR. KELLER: Could I ask you a question on
11 the ethical side of the ledger which I know the bulk
12 of report is more directed or but you were supportive
13 of our model rule of recommendations. You heard our
14 previous speaker and certainly we've heard many
15 witnesses who have suggested that our recommendations
16 would impede rather than aid effective counseling by
17 virtue of having the communication lines of confidence
18 so disrupted because of the fear of erased
19 attorney-client privilege and going to a third party
20 disclosure. What's your thought about that?

21 THE WITNESS: Well, I think there's a couple,
22 I have a couple different thought about that. One, I
23 think the concern has to be taken seriously. It is
24 important that there be that the CEO, the chief, be
25 able to share their concerns and thoughts in a

1 relatively unconstrained way with their counselors
2 with the company's counsel. However, there does need
3 to be, there does need to be again a back stop which
4 we believe is the intent of the rule that you are
5 proposing. The last witness I thought actually gave
6 the most important reason for thinking that the back
7 stop that you're suggesting is not going to have a
8 constraining effect that some think it would. And
9 that is these statements are usually gray.

10 The fundamental politics of a relationship
11 between an organization's counsel and the
12 organization's leadership is a politics of trust and
13 trust on the CEO's part and, frankly, certain amount
14 of dependence on the part of the counsel. There's no
15 getting around that. The introduction of the rule, or
16 rules, such as the one that you are proposing seems to
17 us is likely to simply give an extreme situation, give
18 counsel clear guidance that they are not scions. With
19 respect to their duty that they are offering to
20 clients in their organization. In most circumstances,
21 circumstances where perhaps a plaintiff's attorney or
22 regulator might assert that the law had been broken or
23 was going to be broken, in most circumstances counsel
24 is confident that that's not the case, and would be
25 able and I believe under the rule you're proposing

1 would be able to maintain confidences with their
2 clients and their clients' officers in comfort in that
3 circumstance.

4 What the rule does, though, which is
5 important, is that in an extreme situation in which
6 counsel convinced that illegal conduct is being
7 contemplated that counsel has some leverage to get
8 their opinion heard.

9 MR. CHEEK: Just because I think it is an
10 important point that sometimes gets lost, our proposal
11 is relatively narrow in terms of the capability of
12 believing -- and it only exists when there is that
13 knowledge of a crime and that the lawyers services are
14 being used in furtherance of that there's substantial
15 problem in management.

16 MR. KELLER: I think that's a very tough
17 test, frankly.

18 THE WITNESS: It's tough.

19 MR. TENNILLE: Do you see any problem? We're
20 focussed on corporate governance but these rules that
21 have applications to other organizations, be it
22 nonprofit corporation or --

23 MS. HENNESSY: Unions. This was raised at
24 the last hearing in New York. Not leaning to this but
25 just that the rule should be broader. The rules

1 application need more broadly dealt. All
2 organizations have to accept it.

3 THE WITNESS: We have not processed, let's
4 put it that way, the implications of this rule were it
5 to be explicitly made in every detail broadly
6 applicable. However, I will say one thing about this
7 general question. Under a couple of instances in the
8 past years, the president of the AFL-CIO has been
9 asked about situation which corporate governance
10 issues might have implication for the labor movement.
11 And he has made clear that he believes that there
12 needs to be to the extent that there are similar
13 circumstances, and not always certain circumstances,
14 but to the extent that there are similar circumstances
15 there needs to be a single standard. And I can't tell
16 you today what our view would be of the extent to
17 which every aspects of unionized practice would be
18 similar to corporate side practices. There are
19 substantial differences amongst there.

20 However, I think that principal is one that
21 we are on record on.

22 MR. KELLER: Switching to the shareholder
23 proposal side, I take it in most situation we're
24 talking about target board proposals.

25 THE WITNESS: That's right.

1 MR. KELLER: Do you see a role for the
2 mechanism normal proxy mechanism that really focuses
3 on what shareholders need to do as binding action like
4 elections approval of option plans, fundamental
5 changes and the like for dealing with those regulatory
6 proposals in an environment that keeps it out of the
7 regular process but nevertheless allows shareholders
8 to express their view which the board as managers of
9 the business can take into account if they see fit.

10 THE WITNESS: Well, I'm not sure.

11 MR. KELLER: Let's take it in the electronic
12 era having a separate, if you will, referendum on
13 predatory proposals in which rather than over a time
14 period, shareholders properly identified that's not
15 part of the passwords and the like, essentially record
16 their view on a particular issue.

17 THE WITNESS: Well, I think in general we're
18 not going to be opposed to any increase in the ability
19 of shareholder to communicate with management of the
20 board. However, we have been opposed to a variety of
21 ideas which take that communication out of the setting
22 of the traditional annual meeting. One which has
23 gotten the most attention was the changing of the
24 Delaware statute to allow for virtual annual meetings.
25 A change allows virtual meeting with no physical

1 meeting. A change which to our knowledge only one
2 company has ever taken advantage of. And we're very
3 glad to hear that, that that's the case. We view the
4 opportunities that have been made available by web
5 based communication be an appropriate supplement to
6 traditional meetings.

7 Now, that's not exactly the answer to your
8 question. I would like to address it more precisely.
9 The preparatory natures of the shareholder proposal
10 process in general has both good and bad, both good
11 and bad aspects to it. The good aspects to it is that
12 it allows shareholder to express thier view in general
13 on a matter and give management guidance while leaving
14 to management the details. And leaving the management
15 in fact the ability to reject that recommendation.
16 Now the institution investor community is not happy
17 with that aspect of it, but I think one would be hard
18 -- one would be hard pressed to say that we have done
19 every proposal ought to be mandatory in every detail
20 to management. That preparatory character gives it a
21 certain flexibility which is wise. The problem with
22 it again is it that with the preparatory nature of
23 these proposals is that in some area where the
24 proposal process has been in gear for a long time and
25 the content proposals are pretty well nailed down.

1 And shareholder opinion is pretty unified, so to
2 speak, where typically majority votes. Historically
3 these have included poison pill votes, classified
4 board votes, confidential voting but in recent, in the
5 last year you've seen this in the area of order
6 independence and executive compensation where you're
7 now getting the majority of votes.

8 That is possible for management to simply
9 stonewall in response to these proposals should they
10 choose to do so. That's a problem. There's a strong
11 feeling in institutional investor community well
12 beyond the labor movement that they need to be more
13 binding, greater ability of the shareholders to bring
14 binding proposals. Now the question is if that were
15 ever to be the case should you separate out the
16 preparatory and do it in some other fashion as we were
17 suggesting. I think our view is that it's important
18 that these proposals as long as some kinds of content
19 screen is going on. It's important that those issues
20 which are generally worthy of shareholder
21 consideration be looked at by the shareholders at a
22 time when there's a greatest degree of participation.
23 That's at the annual meeting is likely to remain that
24 way.

25 MR. CHEEK: Since we interrupted your

1 prepared remarks is there anything that you'd like to
2 say in closing to us that we haven't covered?

3 THE WITNESS: Well, I would say that -- what
4 I'd like to emphasize and I think that prepared
5 remarks should be clear about that, I have you live
6 and in person I'll do it again, is that the charge to
7 the task force, this thing, looks like a pretty broad
8 one. You all have chosen to address this series of
9 important but very delimited issues. I did not stick
10 with your delimitation in my testimony and didn't do
11 so for a reason, actually, for two reasons. One is I
12 wanted to, we wanted to make sure that we communicate
13 clearly to you our sense that it is impossible to
14 adequately address the subject matter that the
15 narrative of your draft report lays out within the
16 narrow scope of the specific recommendations that
17 you've set forth, although as you can tell, we're
18 supportive of pretty much everything you said.

19 Secondly, there is a way in which we feel
20 that the issue of corporate's responsibility which is
21 task force reaches beyond even corporate governance
22 matter as narrowly understood that are the bulk of our
23 testimony. There's certain ones that we feel
24 extraordinary strongly about that we make a practice
25 of calling to the attention of anyone who's thinking

1 about the aftermath of last year's corporate scandals
2 on -- the one that I will take up the remainder of my
3 time to address is the issue of the role of company
4 sponsored pension plans for corporate finance or to
5 put it another way, the role of company stock.

6 I know that this is quite far afield from
7 where you started out but in terms of the actual human
8 consequence from last year, the truly irreparable and
9 awful harm that has been done to probably more than
10 100,000 people at Global Crossing, at WorldCom and
11 Enron has been, is centered on this issue. The damage
12 to the larger investing public and pension funds all
13 while very serious and the damage to the markets very
14 extensive has been mitigated by the fact that most of
15 these plans are properly diversified. These people
16 who lost their jobs which is a terrible toll will get
17 their jobs back. Those individuals who lost the bulk
18 of their retirement savings, particularly those in
19 their 40s and 50s of whom there are a lots, tens of
20 thousands, have no -- will never get that money back.
21 There is no -- there is no pool of assets in any
22 plausible defendant great enough to -- great enough
23 to, there's no pool of assets great enough to
24 compensate. And I personally have spent a fair amount
25 of time trying to say to people, you know, I can get

1 you your severance, we can -- all kinds of people are
2 suing on your behalf but the reality is you will never
3 get that money back.

4 Now many people have said we can't stop
5 thieves from being thieves, that's true. But we can,
6 I think, in our account to the business community and
7 to organizations such as the bar which have the
8 ability to set the tone here is that is we could very
9 easily, very easily change the practice in corporate
10 America of loading up these plans with company stock.
11 It would be very easy to do and it would make a great
12 deal of difference if there was certain amount of
13 encouragement. Doesn't have to be done by law. It
14 can be done by a change in the corporate
15 decision-making around this issue.

16 The bar is an organization which in thinking
17 about pension law, tax law, and bankruptcy law could
18 encourage a movement in that direction.

19 MR. CHEEK: Thank you very much. We
20 appreciate you being with us.

21 THE WITNESS: Thank you.

22 MR. CHEEK: We welcome you. Appreciate you
23 coming to visit with us this morning. I know you've
24 distributed your written testimony this morning.
25 Unlike our other witnesses, however, we haven't had a