The Year in Governance

A rising tide of activism — from the high ground of the Aspen Principles to the depths of subprime-shaken boardrooms

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The Aspen Institute’s Judith Samuelson shepherded a reform movement in the making

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The Aspen Principles: A better way forward

A critical mass of ‘strange bedfellows’ came to market in 2007 with a plan to reverse the destructive pull of short-termism. By Judith Samuelson

If we have any doubt about the prevalence — and cost — of “short-termism” in U.S. capital markets, the current economic fallout ought to offer useful data. The subprime crisis, when the final losses are tallied, is being projected by some at $500 billion to up to $1 trillion in destroyed value. The cost of this crisis is felt not only on Wall Street by the banks with their massive loan write-offs but also on Main Street and in communities and neighborhoods by those least able to withstand the financial blow.

The debate has already begun about how to fix the regulatory and corporate governance systems that failed to curb the excesses. But how will the business and investment community respond, not only to the losses of this magnitude but also the suggested fixes? What is the role for companies and their boards?

One response to this question comes from recent action by business, labor, institutional investors, and their respective trade associations. This coalition of “strange bedfellows” has been working to identify the behaviors and practices that contribute to short-termism — and to a better way forward.

Root of this reform movement

The seeds for this coalition were planted when Bill McDonough, then chairman of the Public Company Accounting Oversight Board, issued a charge to participants at the 2004 CEO Summit of the Aspen Corporate Values Strategy Group (CVSG). The topic was market fallout related to Enron and how fixation with quarterly profits undermines long-term value creation and U.S. competitiveness. McDonough’s charge called for 20 “vanguard” companies — with sufficient market cap to move the needle — to become champions of the long-term perspective: evangelizing for it, adopting policies and practices that promote it, and openly communicating their successes and failures in applying it.

In June 2007, this same group released the Aspen Principles for Long-Term Value Creation as a call to action and to build the dialogue about the costs of short-term thinking. Spearheaded by the Business Roundtable (BRT) and the Council of Institutional Investors (CII), this working group of leaders and advocates from business, Wall Street, pension management, and labor had been working for close to a year to identify the factors leading to short-termism, as well as the most promising strategies for reintroducing long-term bias and returning greater balance to capital markets. The participants actively debated — and ultimately agreed on — a set of business and board practices that emphasize long-term focus for the benefit of their companies and the health of the market economy (see excerpt in Exhibit 1 on page 46).

A motivated group

In addition to the leadership of BRT and CII, active members of the working group that produced the Aspen Principles included Steve Odland, CEO of Office Depot and then-chair of the BRT’s Corporate Governance Task Force; governance experts Ira Millstein, John Olson, and John Wilcox; Peggy Foran, Pfizer Inc.’s senior vice president. Continued on page 46
of corporate governance; Fred Buenrostro, who just stepped down as head of CalPERS; and Damon Silvers of the AFL-CIO. Herb Allison, CEO of TIAA-CREF, hosted the CVSG working group on three occasions.

What motivated the participants who engaged in the dialogue and drafting? Members of the professions who participated — like Beth Brooke of Ernst and Young and Jim Quigley of Deloitte — talked about restoring the public confidence in business. McDonough reminded the participants that regulatory action would follow public concern over excessive CEO pay unless business took action first (and a major section of the Principles is dedicated to this topic.) U.S. competitiveness was often discussed — especially the concern that quarter-to-quarter management may negatively influence long-term R&D, for example. Finally, the Aspen Institute’s Business and Society Program, which convened and facilitated the process, asked whether reintroducing a long-term bias could help business to free up talent and innovation to help address complex problems like global warming and global poverty. These are among the many motivations that drew the participants to the table.

Not just a checklist
Chuck Prince, while head of Citigroup, and Jeff Kindler, CEO of Pfizer, challenged the coalition to pursue key principles for long-term value creation rather than a “checklist” of specific practices.

The agreed-upon goal was to illuminate management practices, but also to open dialogue between like-minded companies and long-term-oriented investors such as the union and public pensions. The group engaged in spirited discussion, but attempted to avoid pointing fingers at the cause of short-term pressures. They acknowledged that short-termism is a complex dance involving both companies and investors — and that the principles must speak to both parties in order to bring about real change.

Anne Mulcahy, CEO of Xerox, who endorsed the Principles early on, said the consensus document was “a milestone in business history.” That document, formally titled “Long-Term Value Creation: Guiding Principles for Corporations and Investors,” was what we released to the public in June 2007. It identifies key practices in three areas:

— setting long-term metrics that deemphasize EPS and quarterly profits as the metric of choice;
— communication practices designed to “amplify” the voice of the long-term investor; and
— incentive systems and compensation schemes that reward long-term focus and success.

The Aspen Principles do not address every issue debated in corporate governance circles. They draw from the work of many organizations that have contributed to the critique of short-termism — including the Conference Board’s Blue Ribbon Commission on Public Trust and Private Enterprise, led by Pete Peterson and John Snow after the Enron debacle; the work of funds like CalPERS; and good governance groups like the Committee for Economic Development.

Important signatories
Since the public release of the Aspen Principles, many of the organizations and companies represented in the working group, plus important players like the National Association
of Corporate Directors (NACD), the U.S. Chamber of Commerce, and the Center for Audit Quality (representing the largest public accounting firms), corporations such as Apache, Duke, Office Depot, and PepsiCo, and executive compensation firm Frederic W. Cook & Co., have signed on, illustrating the wide appeal of the Principles’ collaborative approach. The signers are organizations and companies, rather than the individuals who lead them (see Exhibit 2).

Importantly, operating companies and institutional investors who endorse the Principles agree to support each other even in the face of internal and external pressures to compromise on these principles and default to short-term thinking.

A number of supportive parties and signers to the Principles are collaborating on research and education about the corrosive effects of quarterly earnings forecasts — the so-called earnings guidance system. In summer 2008, CVSG participants will convene the annual summit to look at progress and to consider supportive government policy.

The Principles have been the focus of panels and discussions in over a dozen venues, including the NACD’s 2007 annual conference, the Committee for Economic Development working group on corporate governance, Yale’s Millstein Center for Corporate Governance and Performance, and the International Corporate Governance Network.

## Bringing the principles to life

Recent events underscore the importance of this work. Pfizer, one of the early signers, made headlines when it took the unusual step of inviting its largest institutional investors in to discuss long-term drivers of performance, company strategy, and governance practices with members of its board of directors. So the Aspen Principles are already driving change. Meeting the goal of “infecting the wider market,” however, lies ahead.

In the last several months, the CVSG has shifted focus from drafting and communicating about the Aspen Principles to featuring practices that bring the principles to life. The focus is on what is possible: sending the message that individual companies can take action to balance short-term pressure with long-term orientation — that they can and should shift attention from the next quarter to the areas of investment and metrics that secure long-term value.

Concern about short-term pressures is so pervasive. Warren Buffett, Pete Peterson, and Bill Donaldson are among the respected leaders who have continually voiced concern about excessive short-term focus in corporate and investment decision making, pointing to the deleterious effects on firm performance, investor returns, national competitiveness, and long-term economic growth. Fallout even ranges from shrinking CEO tenures to a lessened concern for the public welfare. They cite Google, which captured the notice of the investment community when it eschewed the attention of short-term investors by refusing to forecast its earnings. These leaders seek a better balance in short- and long-term metrics to enable business to do what it does best — create valuable goods and services, invest in innovation, take reasonable risks, and develop human capital. The Aspen Principles stem from this fundamental notion that favoring a long-term perspective will result in better economic returns and a greater business contribution to the public good.

### Powerful resolve

Many CEOs consider reducing short-term market pressures to be outside their purview. Certainly, one company by itself can do little. But history shows that the right people, working in concert, can alter markets for good. In 1950, American statistician W. Edwards Deming convinced 21 leaders of Japan’s most important industries that a focus on quality was the answer to the country’s economic problems. Collectively, these business leaders adopted his recommendations, kicking off what became a manufacturing and economic renaissance for Japan.

The challenge of lengthening time horizons and recalibrating decision rules in business and investing is no less complex a task. It requires powerful commitment and resolve by the most important market players. The good news is that, unlike most attempts at reform, the Aspen Principles for Long-Term Value Creation begin with — rather than build to — critical mass.

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