THE CORPORATE GOVERNANCE ALLIANCE DIGEST

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Published by:

Eleanor Bloxham and John M. Nash, advisors, keynote speakers and authors committed to improving governance and the creation of long-term sustainable value. We provide independent information and advice to CEOs, Boards and Investors related to board governance, external financial and compensation forensics, M&A transactions, and B-to-B customer knowledge.

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This edition of the DIGEST has 5 major sections:

I. BOARDS: NOMINATIONS, SUCCESSION, COMPOSITION, CONFLICTS
II. COMPENSATION TRENDS & ISSUES
III. AUDIT COMMITTEE ALERTS
IV. SHAREHOLDER, COMMUNITY, EMPLOYEE AND CUSTOMER RELATIONS
V. OTHER REGULATORY AND LEGAL UPDATES

QUESTION:
ARE YOU IN FAVOR - OR AGAINST - THE REQUIREMENT THAT DIRECTORS GET A MAJORITY OF THE VOTES TO BE ELECTED? Anonymous vote and comments to ebloxham@thevaluealliance.com

I. BOARDS: NOMINATIONS, SUCCESSION, COMPOSITION, CONFLICTS and ETHICS

The United Brotherhood of Carpenters and Joiners of America, have submitted shareholder proposals at more than 80 companies that would make it easier for investors to reject nominees for corporate boards, requiring a majority vote in favor for directors to be approved. The effort has met with success at several companies, including Advanced Micro Devices Altera and Marathon Oil. Resolutions narrowly defeated at Citigroup, Catepillar and Gannett, and under discussion at Intel, ChevronTexaco, GAP and JP Morgan. The Business Roundtable opposes the majority vote change and may be recommending a set of principles that urge companies to have procedures for holders to communicate with boards and ensure that boards respond to all proposals submitted by holders. (WSJ 5/27)

A study by Booz Allen Hamilton of CEO succession at the world's 2,500 largest companies shows that forced resignations are up 300% from 1995. 14% left office last year and nearly 1/3 of those or 111 were forced out for performance reasons or disagreements with the board. The study also showed that companies where the former CEO became chair under performed other firms - 4.7% lower in North America, 3% lower in Europe and 2.7% in Japan. (Strategy + Business Summer)

SPECIFIC COMPANIES

A group including O.S.S. Capital Management (12.3% holder) plans to nominate 3 candidates to the board of Flamel citing "deep concern" about the decline in stock price. (Barrons 5/23)

Almost 2/3 of shareholders at Career Education (which is under investigation by the SEC and the U.S. Department of Justice) withheld their votes for the company's slate of 3 directors and voted in favor of nonbinding proposals opposed by management including antitakeover provisions. As a result, Career Education said it would add 2 new independent directors to the company's board and reconsider the antitakeover measures. (WSJ 5/23)

TCI a UK hedge fund said it was dropping a proposal to oust Rolf Breuer as chair of Deutsche Boerse's supervisory board at the company's annual meeting. The announcement came two weeks after Deutsche Boerse's board -- in the face of widespread shareholder discontent -- fired CEO Werner Seifert, agreed that three board members would resign to make way for shareholder representatives and said Mr. Breuer would step down as chairman by the end of the year. (WSJ 5/24)

AIG may question Hank Greenberg's right to control $16b in assets, largely stock set aside to pay retirement benefits to senior employees at AIG, owned by Starr International. Separately, Ohio's AG is asking the judge in a class action suit to rescind his recent transfer of 41.4 m A.I.G. shares to his wife, Corinne Greenberg and appoint a receiver to hold the shares until the class-action case has concluded. (FT 5/25, NYT 5/27)

Siebel and Oracle have recently discussed an acquisition of Siebel, but talks aren't active, and none of the offers had been considered by Siebel's full board of directors. Siebel strengthened its takeover defense, promising its nearly 5,300 employees additional severance pay and health coverage if the software company is acquired, with higher benefits for senior executives. While longtime shareholders have exited the stock, activists like Icahn, Tudor, and Jana Partners have added shares. It is too late for them to nominate directors, but they may vote against Tom Siebel at the June 8 meeting. (WSJ 5/26,5/27)

CNBC established rules that barred its managers and news staff, as well as their spouses and dependents, from owning individual securities to avoid potential conflicts of interest in its news coverage, but made an exception for its chair, allowing Pamela Thomas-Graham, to take a seat on the board of Idenix - which included receipt of 15k of stock options and additional compensation. Ms. Thomas-Graham has decided to donate the options to charity and is considering whether to donate her compensation as well. (NYT 5/30)

Summit Partners Management (15.3% holder) said it may file a proxy with a new slate of directors stating that Veramark's board must "immediately acknowledge and assess its long-term track record and current situation under present management, and initiate an immediate and complete review of all strategic alternatives," (Barrons 5/30)

Xmark Asset Management (7.5% holder) has asked Spectrum Pharmaceuticals's board to add an independent director. Xmark has recently raised a number of concerns about executive compensation, the decision to change the board's size from 7 to 5 directors and its role in setting a strategic direction. (Barrons 5/30)

Phillip Goldstein (5.05% holder) intends to nominate "shareholder-friendly directors" because of Neuberger Berman Real Estate Income Fund's board's actions, including extending a poison pill beyond the 120-day limit allowed under the Investment Company Act of 1940. (Barrons 5/30)

II. COMPENSATION TRENDS AND ISSUES

Gehard Schröder's cabinet has agreed to draft legislation to force all German companies listed on the stock market to publish details of director salaries or face a fine of up to €50,000 (£34,000) for each board member. (Guardian 5/20)

According to a survey of 115 companies by Hewitt Associates, 35% are limiting the number of employees eligible for long-term incentive plans. 43% (40% at a 1/3 ratio) are moving from stock options to restricted stock, 33% (40% at a 1/4) ratio to performance-based shares or units, Few are making the shifts at full option value. (CFO 5/24)

New IRS guidelines will likely cost companies more in taxes for executives' personal use of company aircraft. The change is expected to raise $2.3 b in revenue over 10 years. (WSJ 5/27, NYT 5/28)

SPECIFIC COMPANIES

James Kilts, Gillette CEO, who is scheduled to receive $165m if the merger with P&G goes through. has been awarded options valued at $14m with exercise price at the market value on the day of the award to buy 800k shares of stock, Gillette will not offer buyout packages to the approximately 6k employees who are expected to be laid off after the merger, but will offer "appropriate" severance packages. (CFO 5/20)

Rite Aid's, President and CEO, Mary Sammons receives a $12k annual car allowance. John Standley, CFO, and two SVPs each spent approx. $31.2k for the personal use of company cars last year. (NYT 5/22)

Toys R Us executives have retention agreements that provide severance payments and benefits if they are terminated due to a proposed buyout from a private group. The executives, aside from chair and CEO John Eyler, also get a bonus of twice annual salary if still employed when the buyout is completed. (Newday 5/23)

Complaints about executive health care plans were raised as part of the rationale for a strike by more than 2,000 workers at plants in CA and CT that bottle Coca-Cola soft drinks. The company proposed that workers (who earn on average $15 - $20/hour) pay more of their health care costs. It recently provided consulting contracts and lifetime health care coverage for departing executives. (San Jose Mecury 5/23)

Bringing higher US pay to Britain, Barclays Bank, board member Bob Diamond who heads the investment banking arm may be Britain's highest paid boardroom executive. From the US, his base salary is £250,000, with up to £10m performance related bonus in cash and shares, up to £5m long-term incentive plan plus he is eligible for up to £14.85m extra bonus to be paid in 2008 and has shares in the bank (many of which he received free) worth £49m. His current contract calls for him to be paid as much as £15m, or $28 m in 2005, depending on whether he qualifies for full bonuses. By contrast, the total compensation of the 6 other board members (including the outgoing and incoming CEOs) in 2004 was roughly 2/3 of what Mr. Diamond alone could get this year. (Guardian, NYT 5/28)

Compensation of the 7 person board of Sovereign Bancorp contains an inherent conflict of interest - directors get bonuses, tied to whether executive bonus targets are met., which Ralph Whitworth of Relational says could cause directors to be less than objective when approving goals and bonus targets for managers. Also, in 2004, each non-employee director received more total pay than any director of any company in the entire banking industry, receiving average compensation of $313,000. Relational Investors a major shareholder in Soveriegn will nominate competing candidates for 2 board seats scheduled to come up for election next year if Sovereign doesn't reconstitute its board. (WSJ 5/26, CFO 5/27)

US Airways' unions will urge a bankruptcy judge to reject a $55m retention and severance plan that includes $18m for the top 25 officers. US Airways management proposed the plan before the May 19 announcement of its pending merger with America West.. Union members — pilots and others — have taken deep pay cuts to keep the carrier alive. Last year, when former CEO David Siegel collected $4.5 m in severance. And CEO Bruce Lakefield, scheduled to become vice chair of the merged airline, would collect as much as $2.6 m in severance, plus 2 years of health coverage (USA 5/27)

Summer Redstone's pay came under fire at the shareholder meeting, His pay rose 58% to $56m; the 2 co-COOs each earned $52 m. Viacom's stock fell 18%. and they have asked CBS members of the Writers Guild to take a 21% pay cut. (NY Daily News 5/27)

III. AUDIT COMMITTEE ALERTS

Withholding information or lack of forthcoming information is a big issue as demonstrated in the jury trial in which Morgan Stanley has been ordered to pay about $1.45 b to Ronald Perelman because he said Morgan withheld information about Sunbeam's financial problems. The judge instructed the jury to accept Mr. Perleman's story because she said Morgan acted in bad faith in being slow to turn over documents, including a large numbers of e-mails going back nearly a decade. Morgan says it was difficult to find all the information demanded by the court and is appealing the ruling. (Newswk 5/22)

According to an FEI study of 329 companies disclosing controls weaknesses, more than half of 968 disclosed control deficiencies were material weaknesses. Sales revenue, accounts receivable, inventory and accounts payable were the most common areas experiencing internal control shortfalls, Less than 4% were in the area of information technology controls. The larger a company's market cap, the more financial internal-control deficiencies and remediation actions disclosed. (CFO 5/24).

In 2001 and 2002 AIG's audit committee said it did "not provide an independent basis to determine that management has maintained appropriate accounting and financial reporting principles," couldn't assure that the audit had been carried out according to normal standards or even that PWC was in fact "independent.". Other companies included the full disclaimer found in AIG's proxy; these included Goldman Sachs, Wachovia, WorldCom and other companies that later encountered big problems. Many other companies -- Lehman Brothers. and Morgan Stanley, among them -- included milder disclaimers that merely said committee members relied on management and outside auditors for accurate information. Still others -- including McDonald's. and Aon -- went in the opposite direction and took on more responsibility. (WP 5/25)

A conversion to a new system is one of the highest risks that an organization can face. Internal auditors' involvement and independent assessment of the issues and project plans can provide assurance for management and the board with value far in excess of costs. http://www.theiia.org/itaudit/index.cfm?fuseaction=forum&fid=5495

M & A

A recent study by Professors Malmendier and Tate find that CEOs who hold on to in the money options with less than 12 months to expiration (a measure of "overconfidence"/personal risk taking) tend to engage in greater M&A activity (1.65x more likely) and greater diversifying (other industry) M&A activity which generally have poor results (2.45x more likely) than other CEOs. (NYT 5/22)

Most academic studies have found that, on average, acquisitions destroy value. In those instances where value is created, it usually flows to shareholders of the company being acquired. Profs Moeller and Schlingemann studied 4,430 acquisitions by US companies from 1985 to 1995 and found, "US acquirers experience significantly lower stock and operating performance for cross-border than for domestic transactions." Profs Black, Carnes and Jandik's study of the long-term share price performance of 361 successful US bidders for foreign targets found "that in the majority of instances, expansion of US bidding firms through acquisition of foreign targets is a value-destroying activity." (FT 5/29)

According to JP Morgan, despite the rise in M &A and irrespective of deal size, premiums for takeover deals in the US and Europe fell sharply last year to pre-1999 levels; One possible reason: CEOs becoming more cautious about execution risks (FT 5/30)

The merger between Gillette and P & G is under review by the MA secretary of state related to whether Gillette's two investment banks, Goldman Sachs and UBS, withheld information that might have valued the company higher - and therefore whether Gillette shareholders have been shortchanged A review of the deal by Professor Aggarwal seems to indicate the deal was more beneficial to Procter & Gamble shareholders than to Gillette's. Although management may be reluctant to have independent third parties look at the details of any transactions, and boards historically weren't going to question the judgment of management, he believes more directors may be looking to independent parties for fairness opinions, " (CFO 5/20, NYT 5/29)

AUDITORS and AUDIT FEES

According to the study by FEI, about 44% off 329 companies disclosing controls weaknesses and remedial actions experienced a change of auditors; Big 4 firms had a net loss of 59 clients. while the smaller audit firms had a net gain of 49 clients. (CFO 5/24)

The PCAOB revoked the registration of New York-based Goldstein and Morris CPAs. and barred its managing partner, Edward B. Morris, from associating with a registered accounting firm related to violation of the auditor independence rules of the Sarbanes-Oxley Act, The PCAOB found that the firm concealed information from the board and submitted false information in connection with a PCAOB inspection. (CFO 5/25)

The full disclaimer that AIG's audit committee made is being cited in the case Ohio's AG Jim Petro is brining on behalf of 3 pension plans against PWC for its negligence in auditing AIG, in failing to review major transactions, ignoring red flags, and close relations. (Both the former and current CFO came from the C in PWC.) (WP 5/26)

Tony Blair calling for a risk based approach to regulation said "There is a delicious irony in this which illustrates the unintended consequences of regulation.. a bonanza for accountants and auditors the very professions thought to be at fault in the original scandals." (FT 5/27)

ACCOUNTING AND CONTROL ISSUES

100k customers at BofA, PNC, Wachovia, Commerce Bancorp and other bank have had their accounts and personal information placed at risk because of a scheme in which former

bank employees sold account numbers and balances to a man who then sold the data to collection agencies. (WSJ 5/23)
A laptop stolen from the garage of an MCI employee contained personal information and the Social Security numbers of 16.5k employees. Earlier this month, Time Warner disclosed that a container holding personal information on about 600k current and former employees was lost while being shipped by truck in March. (WSJ 5/23)

Joseph Corbett has resigned after just 4 months on the job as CFO of BearingPoint which is currently under investigation by regulators. Former CFO of Oracle and Accenture, CEO Harry You who joined in March will step in as interim CFO. You said: "in about six quarters, plus or minus, everything should be totally rectified." (CFO 5/25)

Maxtor will restate $4 m in its favor as a result of a journal entry that "had been recorded in reverse." - impacting inventory and cgs. (CFO 5/25)

Berkshire Hathaway ended a consulting contract with former General Re Chief Executive Ronald Ferguson after he invoked his Fifth Amendment right when regulators questioned him as part of their investigations into finite reinsurance. (CBS 5/23)

The Australian units of Swiss insurer Zurich Financial Services admitted to overstating earnings after entering into deals with General Re Australia a unit of Warren Buffett's Berkshire Hathaway. Last October,6 employees from the General Re group were disqualified by the Australian regulator APRA over their involvement in a financial transaction between GenRe and FAI Insurance, which improperly boosted FAI's 1998 profit, the same year it was sold to HIH. (WSJ 5/26)

Computer Associates will once again restate results after uncovering old contracts that were not properly recorded. (FT 5/26)

NY's AG and Insurance Dept have filed charges against AIG, former CEO Greenberg and former CFO Smith for manipulation of earnings through special insurance arrangements and other measures to boost reserves and understate underwriting losses. (Forbes, FT, NY Daily News,, WP 5/27)
The FSA plans to fine Citigroup for internal-control failures related to a European bond trade it executed last August (WSJ 5/30)

IV. CUSTOMER, EMPLOYEE, COMMUNITY AND SHAREHOLDER RELATIONS

The Partners for Financial Stability (PFS) fourth semi-annual Survey of Reporting on Corporate Social Responsibility (CSR) by the 10 Largest Listed Companies (by market capitalization) in 11 Central and Eastern European (CEE) countries shows disclosure is up - 71% disclose information about their governance and 41% mention compliance with environmental standards on their websites.
http://www.pfsprogram.org/capitalmarkets_research.php

CUSTOMERS

In an attempt to warn companies of potential side effects or gauge positive or negative opinions that could affect their image, several of the world's leading pharmaceutical groups and at least one regulator are in talks about hiring a Netbank's i-reputation service with software to gather internet conversations about medicines. (FT 5/30)

EMPLOYEES

The employee that gave Wal-Mart information that helped the company investigate vice chair Thomas Coughlin, filed a complaint with the U.S. Labor Department saying the retailer violated federal whistle-blower rules in firing him. (WSJ 5/24)

Firms are turning to retirees for innovative ideas. " Experienced workers are far more able to come up with dramatic ideas and innovations because of their experience and knowledge and wisdom that they've developed over the years," according to the CEO of YourEncore. (WSJ 5/27)

The Peon Book (Berrett-Koehler, 2004), offers the following advice to CEOs and managers: set reasonable expectations, walk around (and don't retaliate based on what you find out), go on vacation, investigate silent turnover, and get into the day to day work to create value. (FC 5/25)

NStar, a public utility, signed a contract and restored, retroactive to the May 16 start of the strike, its 85% contribution to strikers' Blue Cross Blue Shield health insurance which it had cut days after the start of the strike. (BG 5/30)

COMMUNITY

As part of the Prince of Wales Business and Environment programme 13 of Britain's most powerful companies including HSBC, Shell, BP and others said government policy was needed to take action now to avoid the worst impacts of climate change.They pledged to engage other businesses, the UK public, governments and international businesses to back the effort. (Guardian 5/27)

Morgan Stanley and BP informed print publications their companies must be notified of any editorial content about the company, and have the printer pull the company's ads from any edition containing "objectionable editorial coverage." (NWTimes 5/25)

SHAREHOLDERS

Ron Gruner, founder of Shareholder.com, is urging the SEC to change the rules in favor of enabling companies to identify their institutional and retail shareholders, so that they can be positioned for contact, including requiring institutions to file their shareholdings monthly. (Valuation Issues May)

V. OTHER REGULATORY AND LEGAL UPDATES

The US Chamber of Commerce is considering filing ethics complaints against state Ags; supporting legislation that would protect federally regulated companies from their actions; and encouraging other attorneys-general who disapprove of "activists" to change the rules on how state AGs can operate. (FT 5/27)

The Singapore Exchange will now require that companies have specific "channels for reporting significant risk and internal control matters", that "responsibilities for staffing internal controls are explicitly assigned,"and "annual confirmation from the board and CEO that nothing has come to the attention of the board and CEO with regard to internal controls that would have a materially adverse affect on the company." Foreign companies now must have at least two independent resident directors and an adviser on Singapore laws and company information. Existing companies will have two years to comply. (WSJ 5/30)