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STAY TUNED ...
To Things That Go
Bump in the Night
Emerging Trends to Monitor

By Hank Boerner

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STAY TUNED ... To Things That Go Bump in the Night

Emerging Trends to Monitor

By Hank Boerner

In this column, we regularly advise you to “Stay Tuned” to short- and long-term developments, trends or breaking news that could affect corporate America, individual corporations, investor relations officers and IR consultants ... including threats of *things that go bump in the night!* With the passage of Labor Day, we are into the new business year and fast approaching an important presidential election. Below is our current list of trends and developments that will, or could, break into headlines or (in more stealthy ways) affect your professional life.

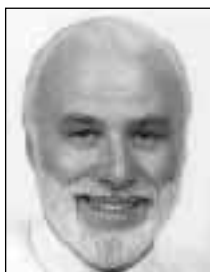
Stay Tuned ... to the immense voting power of public employee pension funds and the muscles fund trustees and money managers are flexing in the capital markets — especially in proxy votes. Stay Tuned’s model for investor activism is California Public Employees Retirement System with its long-standing programs for taking a wide range of actions as the 800-pound institutional investor (\$160 billion assets). One such example is known as the *CalPERS effect*, whereby underperforming stocks are identified by the fund for “action” each year because of poor performance or corporate governance policies. In response, many companies do take action (thanks to the risky headlines and other pressures) and spotlight their improvements over the next year. The CalPERS effect has been known to create as much as a 40 percent share price rise over the next few years.

CalPERS’ 2004 “Focus List” comprised just four firms (1,800 were screened), including the Walt Disney Company.

Its demands to the House of the Mouse: Create more board independence; develop succession plans for the CEO, other executives and the board chair; and tie long-term compensation to performance-based measures. In the heated proxy vote in March, as CalPERS waged a public battle, CEO Michael Eisner stepped down as board chair and recently announced plans to retire in 2006. CalPERS also withheld votes at 11 companies in the spring season, as part of a campaign against companies whose audit committee allowed outside auditors to perform additional services.

Stealth impact to tune in to: Earlier this year, CalPERS presented its external managers and consultants with a code of ethics they must follow if they do business with the fund. The code addresses regular review of money manager compliance by third parties, creation of an ombudsman position with the firm, disclosing all soft-dollar use and costs (such as financial analysis), compensation programs and disclosure of conflicts. These policies will begin to spread in the money management community, no doubt impacting on IRO activities. (Go to www.calpers.ca.gov for details.)

Stay Tuned ... to the fallout as public employee pension fund managers develop coalitions to take on corporate targets. Funds in New York State, New York City, Illinois and Connecticut, for example, withheld votes on the CEO and directors of Safeway over financial performance, board independence and corporate governance issues. The treasurer



Hank Boerner

ers and controllers of the states held a New York City “Wall Street Briefing” for other institutions to lay out their concerns and invite support. CalPERS joined the effort. State treasurers from Massachusetts, Oregon, Iowa, Washington and Maine were also part of the Safeway campaign. Stay tuned to more coalition activism in the 2005 proxy season.

Stay Tuned ... to variations on the themes of activist pension fund managers. Take, for example, New York City’s pension fund, with \$90+ billion in assets. The fund has a long history of activism going back to the 1970s battles over South African apartheid. In early 2004, New York City comptroller William Thompson, who oversees the city’s pension fund, launched the campaign “Doing Business With the Enemy” on CBS’ “60 Minutes” program, targeting companies that do business with “rogue” states such as Iran, Libya and Syria (all accused by activist Thompson of sponsoring terrorism). Thompson and his allies are generating public visibility to focus attention on such firms as Halliburton, ConocoPhillips and General Electric, which he accuses of doing business with “the enemy” by investing in those countries. (The New York City pension fund has \$1 billion invested in these three firms alone.)

Washington, D.C.-based consultant Conflict Securities Advisory Group has identified 400 companies found in most pension fund portfolios that it claims do business in terrorist-sponsored states — for example, 60 firms in Libya alone and 200 companies in Iran. As word of these “corporate terrorist links” spreads through the state and municipal pension fund community — remember, they have \$7 trillion in assets invested in equities! — what will the effects be? While the SEC is supposed to be monitoring these companies, comptroller Thompson sounds the familiar refrain: *We are not waiting; states and cities will now force either the countries or the companies to change their ways.* Recall the similar campaign to bring down the apartheid system by the same investors, and the impact on American companies forced to exit their South African investments.

Stay Tuned ... to another stealth trend that could quickly put your company in the risk headlines: the impact of environmental problems on your balance sheet. We first noted this several years ago as Price

Waterhouse, the Investor Responsibility Research Center, the Environmental Protection Agency, the General Accounting Office and others worked to put the issue of full disclosure of corporate environmental costs front and center before investors and the financial community. This effort gathered steam in the early 1990s but didn’t develop long legs — until now.

In February 2002, the EPA started a national campaign to get public companies to disclose environmental debts to shareholders. We suggested that IROs stay closely tuned to the issue and look at their own company’s potential or real environmental liabilities to quantify the potential hit on earnings, balance sheet, shareowners’ equity, etc.

Today the U.S. Senate is taking up the issue, which could lead to action in the next session of Congress. Sens. Jon Corzine, Joe Lieberman and others held a congressional symposium in July titled “Coming Clean: Corporate Disclosure of Environmental Issues in Financial Statements.” The immediate trigger was the release of a Rose Foundation report “Fooling Investors and Fooling Themselves: How Aggressive Corporate Accounting & Asset Management Tactics Can Lead to

Environmental Accounting Fraud”) and a GAO investigation. (Are you getting the picture?) Rose researchers name corporations; they also explore FASB treatment of liabilities — “environmental transparency” is the objective here. (More information is available at www.rosefdn.org.)

The GAO conducted an 18-month study (GAO-04-808) to see how well the SEC defines the environmental disclosure requirements, how extensively corporations report on liabilities and how the SEC enforces the rules. (Thirty-two companies, including 20 electric utilities, were examined.) This is now the comprehensive database for Senate and House action. (Most GAO reports are available online at www.gao.gov.)

Stay Tuned ... to the future of financial analysis and research. The debate over hard-dollar (issuer-paid) research, soft-dollar research (cost included in trading fees), sell-side versus “independent” research and related issues are (or soon will be) affecting corpora-

tions. New York Attorney General Eliot Spitzer’s settlement with the top 10 Wall Street investment banking houses required the funding (almost \$500 million) of independent research for companies covered by the houses’ own sell-side analysts. Simple solution? Not quite.

Should this have been a boon for true independents? Not according to the Investorside Research Association, a non-profit trade association representing 75 research firms that do not tie payments to investment banking or brokerage businesses. An August survey of its members revealed a dramatic chill in the industry as a growing number of money

managers reduced their commission payments to third-party independents, in part because of uncertainty over the SEC’s task force study of soft-dollar trading.

Virtually all of the responding research firms reported being affected by the “soft-dollar chill” and are laying

off staff or postponing hiring until the agency clears up future rules. The Wall Street Research Global Settlement supports the SEC’s view that investors need much more access to independent research, but the unintended consequence of the SEC task force study has been to discourage more research, says Investorside, claiming money managers are tying commission payments to full-service brokerage. “These hidden, subterranean, bundled commissions continue the abuses because we don’t know who is paying what in the undisclosed pool of trading commissions,” said John Eade, the association’s chairman.

IROs definitely do not need more complications in developing analyst coverage for their companies! (You can follow the association’s arguments at www.investorside.org.)

Stay Tuned ... to the business continuity plans of the major trading floors — especially those of the New York Stock Exchange and Nasdaq Exchange. After the September 11 attacks, both exchanges (being Self-Regulating Organizations) were instructed by the SEC to develop rules to govern continuity in the event of another critical incident. Every NYSE and NASD member firm is affected by this; all have to provide summaries of their plans to customers. Are you up to speed on the plans of the exchange where you list your issues?

See highlights of this effort at three locations: “Policy Statement: Business Continuity Planning for Trading Markets” at www.sec.gov/rules/policy/34-48545.htm; www.nyse.com; and www.nasdaq.com. It’s important for your corporate team to know the official procedures for its public securities should the unthinkable occur again.

These are just some of our top issues to monitor. We’ll be looking at some of these, as well as others not highlighted here, in the months ahead — all to help you to “Stay Tuned” to news, trends and developments that matter most to IROs. **IRU**

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