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Stay Tuned ... to Corporate Governance Reforms

by Hank Boerner

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Stay Tuned ... to Corporate Governance Reforms

By Hank Boerner

Corporate governance and accountability reforms of the past five years continue to roll on, and it is far from being “over,” in this writer’s opinion as a capital markets and corporate America trend watcher. The reforms do come with a price: continuing adjustments for corporate management and added costs for the reforms. A recent Financial Executives Institute survey of CFOs attempted to quantify this: 94 percent of corporate responders think SOX costs exceed the benefits; costs have increased from \$1.9 million to \$4.4 million per year. The prime driver is auditor fees, averaging \$1.3 million in the past year.

Responding to corporate criticism of the recent reforms, the Business Roundtable and the U.S. Chamber of Commerce have launched PR campaigns proclaiming that “enough is enough” and it is time to moderate government reform actions. American and European newspapers have carried articles that would seem to predict that in the coming months, numerous non-

U.S. issuers would quit American exchanges because of SOX and other regulations.

But momentum still appears to be on the side of the reformers. Public opinion has not yet softened toward corporate America. As NIRI President and CEO Lou Thompson has often noted, \$7 trillion in investments “disappeared,” and investors are not happy about this!

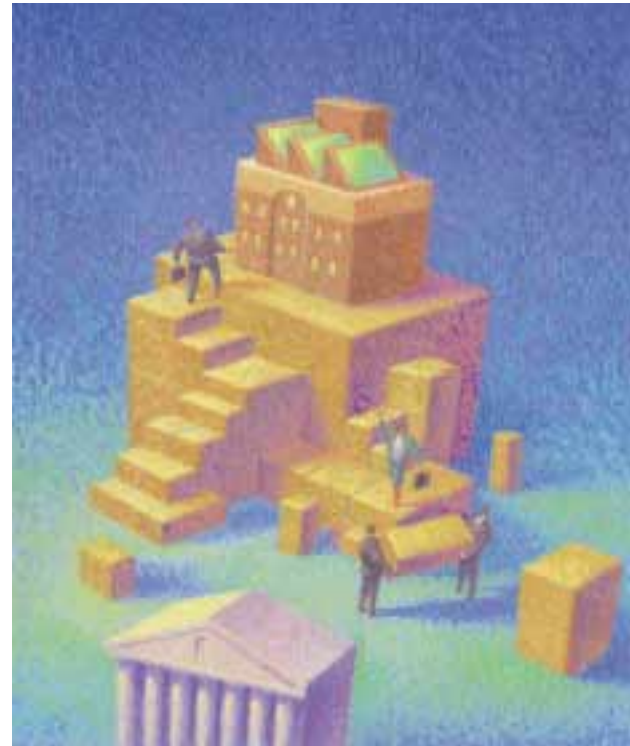
Stay Tuned ...to SEC Chairman Bill Donaldson. In an important policy speech at the London School of Economics, Donaldson had this to say as he gave non-U.S. corporate issuers a bit of breathing room before SOX requirements must be met: “Some critics claim the Sarbanes-Oxley Act goes too far, in particular, Section 404 ... even leading some foreign issuers to declare they may wish to leave America’s capital markets rather than have internal controls certified.

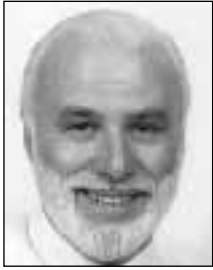
“It is easy for an individual issuer to look at cost of compliance with U.S. federal securities laws ... and balk,” Donaldson continued. “But the cost of

capital comes with benefits — U.S. capital markets are deep and liquid. Nearly half the world’s equity shares by market cap trade in the USA. And non-U.S. investors have \$4.5 trillion invested in U.S. markets. The U.S. government has worked to ensure that there is a range of investor protections and a level playing field. These laws, regulations and enforcement activities make the U.S. markets attractive to foreign investors.”

And these are not the words of an agency chair signaling a weakening of recent reforms: “We want listing and registration in the U.S. to be a signal that the issuer is committed to the highest standards. Our registrants take the extra step to tell the world that they are up to the challenges that accompany a U.S. listing.”

Stay Tuned ...to continuing action in the states. New York State Attorney General Eliot Spitzer addressed the National Press Club in Washington recently in the ongoing public debate over corporate and Wall Street reforms, noting that American





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business leadership is saying, *“Enough. We got the lesson. Back off.”*

In his response, Spitzer — harking back to President Teddy Roosevelt’s campaign against trusts and corporate cartels — said: “I would suggest that we’re in the midst of the same debate [as 100 years ago], that what we have on one side is a business leadership

that cloaks itself in the language of the free market but really wants to preserve an ossified system, and wants to act against those who support competition, transparency and integrity.”

In the Q&A, he asked rhetorically, *“Now that we know what we know — for instance, about distortions in financial analyst commentary or mutual fund late trading — do any of us want to go back to the way things were?”* This comment is a continuing theme in Spitzer’s crusade against corporate and capital markets wrongdoing, even as he sets his cap for the governor’s mansion in 2006.

Stay Tuned ... to California and CalPERS. A bellwether institutional investor and activist is CalPERS — the California Public Employees Retirement System — with 1.4 million beneficiaries and \$186 billion in assets. CalPERS is still on a tear, continuing its powerful drive for corporate governance reforms. The fund has corporate governance standards to guide its shareowner activism and regularly issues policy enhancements. Consider its recent actions/decisions:

The pension fund managers want to improve transparency and timely disclosure of corporate environmental impacts and are targeting companies in which the fund invests to: sign onto the Global Carbon Disclosure Project; improve data transparency in the auto industry; create model greenhouse gases reporting protocols for the utilities industry; and recognize outstanding companies that demonstrate best practices in environmental data transparency.

CalPERS favors a majority vote for corporate board candidates. “Embarking on a new frontier in its corporate governance program,” said CalPERS, the organization is launching a three-pronged effort directed at corporations it invests in. First, CalPERS will seek to implement majority policies at companies through changes in corporate bylaws and charter amendments. Second, the fund will pursue changes in state laws to implement majority votes. Third,

CalPERS will seek to implement the concept at the SEC and major stock exchanges.

CalPERS adopted a staff recommendation to use the Public Company Accounting Oversight Board auditor independence proposals as a guideline for the fund’s 2005 proxy voting, which proposes that auditors be barred from advising clients on tax shelters and other money-saving measures.

When auditors are up for renewal, they could see proxy votes withheld if they “violate” the proposed standards for individual companies in the CalPERS equity portfolio that are part of an internal resource, the Wilshire 2500 Index Fund. There’ll be separate proxy votes against individual corporate audit committee members where there are “signs of egregious behavior” among these companies.

Stay Tuned ... to New York State Comptroller Alan Hevesi, the sole trustee of the \$100-plus billion state employees’ fund. The popular comptroller is suing Merck & Company for allegations of “misleading shareholders” about the safety of arthritis pain drug Vioxx, claiming the fund lost \$171 million in 2004 when the company withdrew the drug from the marketplace. “Merck must be held legally responsible for its action,” Hevesi thundered. The company disputes the charges.

Hevesi also took on the independent directors of Enron and WorldCom, accusing them of causing the loss of billions of dollars’ worth of valuation of the state fund, and in settlements that are now ringing alarm bells in many boardrooms, demanded that directors yield specific percentages of their personal net worth. WorldCom’s 11 independent trustees will pay \$20 million each to settle the class action.

Given the wide scope of these and many other drivers of corporate governance reform, this writer would not bet on a sea change in investor, government, media and activist opinion about the importance of reform anytime soon. IROs are best advised to **Stay Tuned to the reforms** under way and still emerging. It is a new and challenging operating environment for the 4,000-plus public companies so far directly affected by SOX. [IRU](#)

Hank Boerner, a longtime corporate governance consultant to corporations and institutions, is managing director-New York, Rowan & Blewitt. The opinions expressed are his own. He can be reached at hank@hankboerner.com.