THE CALIFORNIA PUBLIC EMPLOYEES'
RETIREMENT SYSTEM

GLOBAL PRINCIPLES

OF

ACCOUNTABLE

CORPORATE GOVERNANCE

"Everywhere shareholders are re-examining their relationships with company bosses – what is known as their system of 'corporate governance.' Every country has its own, distinct brand of corporate governance, reflecting its legal, regulatory and tax regimes… The problem of how to make bosses accountable has been around ever since the public limited company was invented in the 19th century, for the first time separating the owners of firms from the managers who run them…."

"Corporate Governance: Watching the Boss," THE ECONOMIST 3 (Jan. 29, 1994).

California Public Employees' Retirement System
Lincoln Plaza - 400 Q Street - Sacramento, CA 95811

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I. INTRODUCTION

The California Public Employees' Retirement System (CalPERS) is the largest U.S. public pension fund, with assets totaling $250 billion spanning domestic and international markets as of May 9, 2008. ***Our mission is to advance the financial and health security for all who participate in the System. We will fulfill this mission by creating and maintaining an environment that produces responsiveness to all those we serve.*** This statement was adopted by the CalPERS Board of Administration to guide us in serving our more than 1.5 million members and retirees.

The CalPERS Board of Administration is guided by the Board's Investment Committee, management, and more than 210 Investment Office staff who carry out the daily activities of the investment program. Our goal is to efficiently and effectively manage investments to achieve the highest possible return at an acceptable level of risk. In doing so, CalPERS has generated strong long-term returns.

CalPERS' Corporate Governance[1] Program is a product of the evolution that only experience and maturity can bring. In its infancy in 1984-87, corporate governance at CalPERS was solely reactionary: reacting to the anti-takeover actions of corporate managers that struck a dissonant chord with one's sense – as owners of the corporate entity – of accountability and fair play. The late 1980s and early 1990s represented a period in which CalPERS learned a great deal about the "rules of the game" – how to influence corporate managers, what issues were likely to elicit fellow shareowner support, and where the traditional modes of shareowner/corporation communication were at odds with current reality.

Beginning in 1993, CalPERS turned its focus toward companies considered by virtually every measure to be "poor" financial performers. By centering its attention and resources in this way, CalPERS could demonstrate very specific and tangible results[2] to those who questioned the value of corporate governance.

What have we learned over the years? We have learned that (a) company managers want to perform well, in both an absolute sense and as compared to their peers; (b) company managers want to adopt long-term strategies and visions, but often do not feel that their shareowners are patient enough; and (c) <u>all</u> companies – whether governed under a structure of full accountability or not – will inevitably experience both ascents and descents along the path of profitability.

We have also learned, and firmly embrace the belief that good corporate governance – that is, accountable corporate governance – means the difference between wallowing for long periods in the depths of the performance cycle, and responding quickly to correct the corporate course. As one commentator noted:

> *"Darwin learned that in a competitive environment an organism's chance of survival and reproduction is not simply a matter of chance. If one organism has even a tiny edge over the others, the advantage becomes amplified over time. In*

[1] "Corporate Governance," at CalPERS, means the "relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) shareowners, (2) management (led by the chief executive officer), and (3) the board of directors." (Robert Monks and Nell Minow, CORPORATE GOVERNANCE 1 (1995).)

[2] See Steven L. Nesbitt, "Long-Term Rewards from Shareholder Activism: A Study of the 'CalPERS Effect'," J. OF APP. CORP. FIN. 75 (Winter 1994): Concluding that CalPERS' program generates approximately $150 million, per year, in added returns. See Anson, White, and Ho "Good Corporate Governance Works: More Evidence from CalPERS," Journal of Asset Management, Vol.5, 3 (February 2004), 149-156. Also see "The Shareholder Wealth Effects of CalPERS' Focus List," Journal of Applied Corporate Finance, (Winter 2003), 8-17: The authors found that between 1992 and 2002, publication of the CalPERS "Focus List" and efforts to improve the corporate governance of companies on that list generated one-year average cumulative excess returns of 59.4%. Cumulative excess return is the cumulative "return earned over and above the risk-adjusted return required for each public corporation."

'The Origin of the Species,' Darwin noted, `A grain in the balance will determine which individual shall live and which shall die.' I suggest that an independent, attentive board is the grain in the balance that leads to a corporate advantage. A performing board is most likely to respond effectively to a world where the pace of change is accelerating. An inert board is more likely to produce leadership that circles the wagons."

Ira M. Millstein, New York Times, April 6, 1997, Money & Business Section, p. 10.

II. PURPOSE

The Global Principles of Accountable Corporate Governance ("Principles") create the framework by which CalPERS executes its proxy voting responsibilities. In addition, the Principles provide a foundation for supporting the System's corporate engagement and governance initiatives to achieve long-term sustainable risk adjusted investment returns. Throughout this document, CalPERS has chosen to adopt the term "shareowner" rather than "shareholder." This is to reflect a view that equity ownership carries with it active responsibilities[3] and is not merely passively "holding" shares. As a shareowner**,** CalPERS implements its proxy voting responsibility and corporate governance initiatives in a manner that is consistent with the Principles unless such action may result in long-term harm to the company that outweighs all reasonably likely long-term benefit; or, unless such a vote is contrary to the interests of the beneficiaries of CalPERS' system.

The execution of proxies and voting instructions is an important mechanism by which shareowners can influence a company's operations and corporate governance. It is therefore important for shareowners to exercise their right to participate in the voting and make their decisions based on a full understanding of the information and legal documentation presented to them. CalPERS will vote in favor of or "For", an individual or slate of director nominees up for election that the System believes will effectively oversee CalPERS' interests as a shareowner consistent with the Principles. However, CalPERS will withhold its vote from or vote "Against" an individual or slate of director nominees at companies that do not effectively oversee CalPERS' interests as a shareowner consistent with the Principles. CalPERS will also withhold its vote in limited circumstances where a company has consistently demonstrated long-term economic underperformance.

CalPERS' Global Principles are broken down into four areas – Core, Domestic, International, and Emerging Markets Principles. Adopting the Principles in its entirety may not be appropriate for every company in the global capital marketplace due to differing developmental stages, competitive environment, regulatory or legal constraints. However, CalPERS does believe the criteria contained in the Core Principles can be adopted by companies across all markets - from developed to emerging – in order to establish the foundation for achieving long-term sustainable investment returns through accountable corporate governance structures.

For companies in the United States or listed on U.S. stock exchanges, CalPERS advocates the expansion of the Core Principles into the Domestic Principles of Accountable Corporate Governance. For companies outside the United States or listed on non-U.S. stock exchanges, CalPERS advocates the expansion of the Core Principles into the International Principles of Accountable Corporate Governance. And in emerging capital markets, CalPERS advocates the expansion of the Core Principles into the Emerging Markets Principles of Accountable Corporate Governance in order to promote sustainable economic, environmental, and social development while striving to establish a governance framework that is consistent with International Principles.

[3] "For corporate governance structures to work effectively, Shareowners must be active and prudent in the use of their rights. In this way, Shareowners must act like owners and continue to exercise the rights available to them." (2005 CFA Institute: Centre for Financial Market Integrity, The Corporate Governance of Listed Companies: A Manual for Investors)

III. PRINCIPLES of ACCOUNTABLE CORPORATE GOVERNANCE

A. Core Principles of Accountable Corporate Governance

There are many features that are important considerations in the continuing evolution of corporate governance best practices. However, the underlying tenet for CalPERS' Core Principles of Accountable Corporate Governance is that fully accountable corporate governance structures produce, over the long term, the best returns to shareowners. CalPERS believes the following Core Principles should be adopted by companies in all markets – from developed to emerging – in order to establish the foundation for achieving long-term sustainable investment returns through accountable corporate governance structures.

1. **Optimizing Shareowner Return:** Corporate governance practices should focus the board's attention on optimizing the company's operating performance, profitability and returns to shareowners.

2. **Accountability:** Directors should be accountable to shareowners and management accountable to directors. To ensure this accountability, directors must be accessible to shareowner inquiry concerning their key decisions affecting the company's strategic direction.

3. **Transparency:** Operating, financial, and governance information about companies must be readily transparent to permit accurate market comparisons; this includes disclosure and transparency of objective globally accepted minimum accounting standards, such as the International Financial Reporting Standards ("IFRS").

4. **One-share/One-vote:** All investors must be treated equitably and upon the principle of one-share/one-vote.

5. **Proxy Materials:** Proxy materials should be written in a manner designed to provide shareowners with the information necessary to make informed voting decisions. Similarly, proxy materials should be distributed in a manner designed to encourage shareowner participation. All shareowner votes, whether cast in person or by proxy, should be formally counted with vote outcomes formally announced.

6. **Code of Best Practices:** Each capital market in which shares are issued and traded should adopt its own Code of Best Practices to promote transparency of information, prevention of harmful labor practices, investor protection, and corporate social responsibility. Where such a code is adopted, companies should disclose to their shareowners whether they are in compliance.

7. **Long-term Vision:** Corporate directors and management should have a long-term strategic vision that, at its core, emphasizes sustained shareowner value. In turn, despite differing investment strategies and tactics, shareowners should encourage corporate management to resist short-term behavior by supporting and rewarding long-term superior returns.

8. **Access to Director Nominations:** Shareowners should have effective access to the director nomination process.

B. Domestic Principles of Accountable Corporate Governance (United States)

In the United States, CalPERS advocates the expansion of the Core Principles by companies domiciled in the United States or that list shares on U.S. stock exchanges into the Domestic Principles of Accountable Corporate Governance. CalPERS' Domestic Principles embrace the Council of Institutional Investors Corporate Governance Policies (Appendix A) and represent an evolving framework for accountable corporate governance to be applied to the U.S. capital market. In addition to encouraging portfolio

companies to adopt these principles, CalPERS implements its U.S. corporate governance initiatives and proxy voting responsibilities in a manner that is consistent with the following Domestic Principles:

1. Board Independence & Leadership

Independence is the cornerstone of accountability. It is now widely recognized throughout the U.S. that independent boards are essential to a sound governance structure. Nearly all corporate governance commentators agree that boards should be comprised of at least a majority of "independent directors." But the definitional independence of a majority of the board may not be enough in some instances. The leadership of the board must embrace independence, and it must ultimately change the way in which directors interact with management. Independence also requires a lack of conflict between the director's personal, financial, or professional interests, and the interests of shareowners.

> *"A director's greatest virtue is the independence which allows him or her to challenge management decisions and evaluate corporate performance from a completely free and objective perspective. A director should not be beholden to management in any way. If an outside director performs paid consulting work, he becomes a player in the management decisions which he oversees as a representative of the shareholder…."*
>
> Robert H. Rock, Chairman NACD, DIRECTORS & BOARDS 5 (Summer 1996).

Accordingly, to instill board independence and leadership, CalPERS recommends:

1.1 Majority of Independent Directors: At a minimum, a majority of the board consists of directors who are independent. Boards should strive to obtain board composition made up of a substantial[4] majority of independent directors.

1.2 Independent Executive Session: Independent directors meet periodically (at least once a year) alone in an executive session, without the CEO. The independent board chair or lead (or presiding) independent director should preside over this meeting.

1.3 Independent Director Definition: Each company should disclose in its annual proxy statement the definition of "independence" relied upon by its board. The board's definition of "independence" should address, at a minimum, those provisions set forth in Appendix B.

1.4 Independent Board Chairperson: The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interest of shareowners, and it should name a lead independent director to fulfill duties that are consistent with those provided in Appendix C.

1.5 Examine Separate Chair/CEO Positions: When selecting a new chief executive officer, boards should re-examine the traditional combination of the "chief executive" and "chair" positions.

1.6 Board Role of Retiring CEO: Generally, a company's retiring CEO should not continue to serve as a director on the board and at the very least be prohibited from sitting on any of the board committees.

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[4] The National Association of Corporate Directors' (NACD's) Blue Ribbon Commission on Director Professionalism released its report in November 1996. (Hereafter "NACD Report") The NACD Report calls for a "substantial majority" of a board's directors to be independent. The Business Roundtable's Principles of Corporate Governance (November 2005, hereafter "BRT Principles") is in general accord that a "substantial majority" of directors should be independent, both in fact and appearance, as determined by the board. (BRT Principles, p.14) Neither the NACD, nor BRT, define "substantial."

1.7 Board Access to Management: The board should have a process in place by which all directors can have access to senior management.

1.8 Independent Board Committees: Committees who perform the audit, director nomination and executive compensation functions should consist entirely of independent directors.

1.9 Board Oversight: The full board is responsible for the oversight function on behalf of shareowners. Should the board decide to have other committees (e.g. executive committee) in addition to those required by law, the duties and membership of such committees should be fully disclosed.

1.10 Board Resources: The board, through its committees, should have access to adequate resources to provide independent counsel advice, or other tools that allow the board to effectively perform its duties on behalf of shareowners.

2 Board, Director, and CEO Evaluation

No board can truly perform its function of overseeing a company's strategic direction and monitoring management's success without a system of evaluating itself. In CalPERS' view, each director should fit within the skill sets identified by the board as necessary to focus board attention on optimizing company operating performance and returns to shareowners. No director can fulfill his or her potential as an effective board member without a personal dedication of time and energy. Corporate boards should therefore have an effective means of evaluating itself and individual director performance.

With this in mind, CalPERS recommends that:

2.1 Corporate Governance Principles: The board adopts and discloses a written statement of its own governance principles, and re-evaluates them on at least an annual basis.

2.2 Director Skill Sets and Diversity: The board establishes and discloses the mix of director attributes, experiences, diverse perspectives and skill sets that are most appropriate for the company. Core attributes of directors that make up a board should address accounting or finance, international markets, business or management experience, industry knowledge, customer-base experience or perspective, crisis response, leadership and strategic planning as well as address historically under-represented groups on the board, including women and minorities.

2.3 Board, Committee, and Director Expectations: The board establishes preparation, participation and performance expectations for itself (acting as a collective body), for the key committees and each of the individual directors. A process by which these established board, key committee and individual director expectations are evaluated on an annual basis should be disclosed to shareowners. Directors must satisfactorily perform based on the established expectations with renomination based on any other basis being neither expected nor guaranteed.

2.4 Director Nominations: With each director nomination recommendation, the board should consider the issue of continuing director tenure, as well as board diversity, and take steps as necessary to ensure that the board maintains openness to new ideas and a willingness to critically re-examine the status quo.

2.5 Director Time Commitment: The board adopts and discloses guidelines[5] in the company's proxy statement to address competing time commitments that are faced when directors, especially acting CEOs[6], serve on multiple boards.

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[5] See NACD Report, at p. 10-12 recommending that candidates who are CEOs or senior executives of public corporations be "preferred" if they hold no more than 1-2 public company directorships; other candidates who hold full-time positions be preferred if they hold no more than 3-4 public company directorships; and all other candidates be preferred if they hold no more than 5-6 other public company directorships.

2.6 Director Attendance: Directors should be expected to attend at least 75% of the board and key committee meetings on which they sit.

2.7 Board Size: The board periodically reviews its own size, and determines the size that is most effective toward future operations.

2.8 CEO Performance: Independent directors establish CEO performance criteria focused on optimizing operating performance, profitability and shareowner value creation; and regularly review the CEO's performance against those criteria.

2.9 CEO Succession Plan: The board should proactively lead and be accountable for the development, implementation, and continual review of a CEO succession plan. Board members should be required to have a thorough understanding of the characteristics necessary for a CEO to execute on a long-term strategy that optimizes operating performance, profitability and shareowner value creation. At a minimum, the CEO succession planning process should:

a. Become a routine topic of discussion by the board.
b. Extend down throughout the company emphasizing the development of internal CEO candidates and senior managers while remaining open to external recruitment.
c. Require all board members be given exposure to internal candidates.
d. Encompass both a long-term perspective to address expected CEO transition periods and a short-term perspective to address crisis management in the event of death, disability or untimely departure of the CEO.
e. Provide for open and ongoing dialogue between the CEO and board while incorporating an opportunity for the board to discuss CEO succession planning without the CEO present.
f. Be disclosed to shareowners on an annual basis and in a manner that would not jeopardize the implementation of an effective and timely CEO succession plan.

2.10 Director Succession Plan: The board should proactively lead and be accountable for the development, implementation, and continual review of a director succession plan. Board members should be required to have a thorough understanding of the characteristics necessary to effectively oversee management's execution of a long-term strategy that optimizes operating performance, profitability, and shareowner value creation. At a minimum, the director succession planning process should:

a. Become a routine topic of discussion by the board.
b. Encompass how expected future board retirements or the occurrence of unexpected director turnover as a result of death, disability or untimely departure is addressed in a timely manner.
c. Encompass how director turnover either through transitioning off the board or as a result of rotating committee assignments and leadership is addressed in a timely manner.
d. Provide for a mechanism to solicit shareowner input.
e. Be disclosed to shareowners on an annual basis and in a manner that would not jeopardize the implementation of an effective and timely director succession plan.

3 Executive & Director Compensation

Compensation programs are one of the most powerful tools available to the company to attract, retain, and motivate key employees to optimize operating performance, profitability and sustainable long-term shareowner return. Well-designed compensation programs will be adequately disclosed and align management with the long-term economic interests of shareowners. CalPERS believes shareowners should have an effective mechanism by which to periodically promote substantive dialogue, encourage

[6] "The job of being the CEO of a major corporation is one of the most challenging in the world today. Only extraordinary people are capable of performing it adequately; a small portion of these will appropriately be able to commit some energy to directorship of one other enterprise. No CEO has time for more than that." (Robert A.G. Monks, "Shareholders and Director Section", DIRECTORS & BOARDS (Autumn 1996 p.158)

independent thinking by the board, and stimulate healthy debate for the purpose of holding management accountable for performance through executive compensation programs. However, CalPERS does not generally believe that it is optimal for shareowners to approve individual contracts at the company specific level.

Implicit in CalPERS' U.S. Principles related to executive compensation, is the belief that the philosophy and practice of executive compensation needs to be more performance-based. Through its efforts to advocate executive compensation reform, CalPERS emphasizes improved disclosure, the alignment of interests between executive management and shareowners, and enhanced compensation committee accountability for executive compensation.

With this in mind, CalPERS recommends the following:

Executive Compensation

3.1 Structure and Components of Total Compensation

a. **Board Designed, Implemented, and Disclosed to Shareowners:** To ensure the alignment of interest with long-term shareowners, executive compensation programs are to be designed, implemented, and disclosed to shareowners by the board, through an independent compensation committee. Executive compensation programs should not restrict the company's ability to attract and retain competent executives.

b. **Mix of Cash and Equity:** Executive compensation be comprised of a combination of cash and equity based compensation.

c. **Shareowner Advisory Vote on Executive Compensation:** Companies submit executive compensation policies to shareowners for non-binding approval on an annual basis.

d. **Executive Contract Disclosure:** Executive contracts be fully disclosed, with adequate information to judge the "drivers" of incentive components of compensation packages.

e. **Targeting Total Compensation Components:** Overall target ranges of total compensation and components therein including base salary, short-term incentive and long-term incentive components should be disclosed.

f. **Peer Relative Analysis:** Disclosure should include how much of total compensation is based on peer relative analysis and how much is based on other criteria.

3.2 Incentive Compensation

a. **Performance Link:** A significant portion of executive compensation should be comprised of "at risk" pay linked to optimizing the company's operating performance and profitability that results in sustainable long-term shareowner value creation.

b. **Types of Incentive Compensation:** The types of incentive compensation to be awarded should be disclosed such as the company's use of options, restricted stock, performance shares or other types.

c. **Establishing Performance Metrics:** Performance metrics such as total stock return, return on capital, return on equity and return on assets, should be set before the start of a compensation period while the previous years' metrics which triggered incentive payouts should be disclosed.

d. **Multiple Performance Metrics:** Plan design should utilize multiple performance metrics when linking pay to performance.

e. **Performance Hurdles:** Performance hurdles[7] that align the interests of management with long-term shareowners should be established with incentive compensation being directly tied to the attainment and/or out-performance of such hurdles. Provisions by which compensation will not be paid if performance hurdles are not obtained should be disclosed to shareowners.

f. **Retesting Incentive Compensation:** Provisions for the resetting of performance hurdles in the event that incentive compensation is retested[8] should be disclosed.

g. **Clawback Policy:** Companies should recapture incentive payments that were made to executives on the basis of having met or exceeded performance targets during a period of fraudulent activity or a material negative restatement of financial results for which executives are found personally responsible.

3.3 Equity Compensation

a. **Equity Ownership:** Executive equity ownership should be required through the attainment and continuous ownership of a significant equity investment in the company. Executive stock ownership guidelines and holding requirements should be disclosed to shareowners on an annual basis. In addition to equity ownership, the company should make full disclosure of its hedging policies.

b. **Equity Grants Linked to Performance:** Equity based compensation plans should incorporate performance based equity grant vesting requirements tied to achieving performance metrics. The issuance of discounted equity grants or ~~time~~ accelerated vesting are not desirable performance based methodologies.

c. **Unvested Equity Acceleration upon a Change-in-Control:** In the event of a merger, acquisition, or change-in-control, unvested equity should not accelerate but should instead convert into the equity of the newly formed company.

d. **Recapturing Dividend Equivalent Payouts:** Companies should develop and disclose a policy for recapturing dividend equivalent payouts on equity that does not vest. In addition, companies should ensure voting rights are not permitted on unvested equity.

e. **Equity Grant Vesting Period:** Equity grants should vest over a period of at least three years.

f. **Board Approval of Stock Options:** The board's methodology and corresponding details for approving stock options for both company directors and employees should be highly transparent and include disclosure of: 1) quantity, 2) grant date, 3) strike price, and 4) the underlying stock's market price as of grant date. The approval and granting of stock options for both directors and employees should preferably occur on a date when all corporate actions are taken by the board. The board should also require a report from the CEO stating specifically how the board's delegated authority to issue stock options to employees was used during the prior year.

g. **Equity Grant Repricing:** Equity grant repricing without shareowner approval should be prohibited.

h. **Evergreen or Reload Provisions:** "Evergreen"[9] or "Reload"[10] provisions should be prohibited.

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[7] Executive compensation should directly link the interests of senior management, both individually and as a team, to the long-term interests of shareholders. It should include significant performance-based criteria related to long-term shareholder value and should reflect upside potential and downside risk. (BRT Principles pg. 24)

[8] "Retested" means extending a performance period to enable initial performance hurdles to be achieved.

[9] Evergreen provisions provide a feature that automatically increases the shares available for grant on an annual basis. Evergreen provisions include provisions for a set number of shares to be added to the plan each year, or a set percentage of outstanding shares.

i. **Distribution of Equity Compensation:** How equity-based compensation will be distributed within various levels of the company should be disclosed.

j. **Equity Dilution and Run Rate Provisions:** Provisions for addressing the issue of equity dilution, the intended life of an equity plan, and the expected yearly run rate of the equity plan should be disclosed.

k. **Equity Repurchase Plans:** If the company intends to repurchase equity in response to the issue of dilution, the equity plan should clearly articulate how the repurchase decision is made in relation to other capital allocation alternatives.

l. **Shareowner Approval:** All equity based compensation plans or material changes to existing equity based compensation plans should be shareowner approved.

m. **Cost of Equity Based Compensation:** Reasonable ranges which the board will target the total cost of new or material changes to existing equity based compensation plans should be disclosed. The cost of new or material changes to existing equity based compensation plans should not exceed that of the company's peers unless the company has demonstrated consistent long-term economic out performance on a peer relative basis.

3.4 Use and Disclosure of Severance Agreements

a. **Severance Agreement Disclosure:** In cases where the company will consider severance agreements[11], the policy should contain the overall parameters of how such agreements will be used including the specific detail regarding the positions within the company that may receive severance agreements; the maximum periods covered by the agreements; provisions by which the agreements will be reviewed and renewed; any hurdles or triggers that will affect the agreements; a clear description of what would and would not constitute termination for cause; and disclosure of where investors can view the entire text of severance agreements.

b. **Severance Agreement Amendments:** Material amendments to severance agreements should be disclosed to shareowners.

c. **Shareowner Approval of Severance Payments:** Severance payments that provide benefits[12] with a total present value exceeding market standards[13] should be ratified by shareowners.

3.5 Use of "Other" Forms of Compensation

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[10] Reload provisions allow an optionee who exercises a stock option using stock already owned to receive a new option for the number of shares used to exercise. The intent of reload options is to make the optionee whole in cases where they use existing shares they own to pay the cost of exercising options.

[11] Severance agreement means any agreement that dictates what an executive will be compensated when the company terminates employment without cause or when there is a termination of employment following a finally approved and implemented change in control.

[12] Severance benefits mean the value of all cash and non-cash benefits, including, but not limited to, the following: (i) cash benefits; (ii) perquisites; (iii) consulting fees; (iv) equity and the accelerated vesting of equity, (v) the value of "gross-up" payments; and (vi) the value of additional service credit or other special additional benefits under the company's retirement system. Severance benefits do not include already accrued pension benefits.

[13] The disclosed threshold in the United States should not exceed 2.99 times the sum of the executive's base salary plus target bonus.

a. **Alternative Forms of Compensation:** Compensation policies should include guidelines by which the company will use alternative forms[14] of compensation ("perquisites"), and the relative weight in relation to total compensation if perquisites will be utilized. To the degree that the company will provide perquisites, it should clearly articulate how shareowners should expect to realize value from these other forms of compensation.

3.6 Use of Retirement Plans

a. **Defined Contribution/Benefit Plans:** Defined contribution and defined benefit retirement plans should be clearly disclosed in tabular format showing all benefits available whether from qualified or non-qualified plans and net of any offsets.

Director Compensation

3.7 Director Compensation

a. **Combination of Cash and Equity:** Director compensation should be a combination of cash and stock in the company.

b. **Equity Ownership:** Director equity ownership should be required through the attainment and continuous ownership of an equity investment in the company. Director stock ownership guidelines and holding requirements should be disclosed to shareowners on an annual basis.

4 ~~Audit Integrity~~Integrity of Financial Reporting

As a shareowner, CalPERS has a vested interest in maintaining the integrity and efficiency of the capital markets. For this reason, CalPERS is a strong supporter of reform to ensure the integrity of financial reporting. CalPERS believes that independence and objectivity of the external auditor is necessary to maintain investor's confidence in the market.

To maintain investor's confidence, companies should support the development of an accurate audited financial reporting framework. CalPERS believes annual audits of financial reporting should be required for all companies and carried out by an independent external auditor. The overall objective of a financial statement audit is to evaluate whether the financial statements meet financial reporting, governance and control standards and applicable legal and regulatory requirements. This audit should provide an objective opinion that the financial statements and accounts give a true and fair view of the company's financial state, that the company kept proper accounting records, and that these records contain accurate information about the entity's resources, claims to those resources and changes in resources and claims. The audit opinion should state that it is useful primarily to the existing shareowners and creditors and secondarily to potential investors, creditors and others making similar resource allocation decisions. CalPERS recommends the following:

4.1 Auditor Ratification by Shareowners: The selection of the independent external auditor should be ratified by shareowners annually.

4.2 Non-Audit Fees: The board, through its independent Audit Committee, should ensure that excessive non-audit fees are prohibited. To limit the risk of possible conflicts of interest and independence of the auditor, non-audit services and fees paid to auditors for non-audit services should both be approved in advance by the Audit Committee and disclosed in the proxy statement on an annual basis.

4.3 Auditor Independence: The Audit Committee should assess the independence of the external auditing firm on an annual basis. Prior to acceptance of an external auditor engagement, the Audit Committee should require written disclosure from the external auditor of:

[14] "Other" forms of compensation include, but are not limited to, pension benefits including terms of deferred pay, perquisites and loans.

a. all relationships between the registered public accounting firm or any affiliates of the firm and the potential audit clients or persons in a financial reporting oversight role that may have a bearing on independence;

b. the potential effects of these relationships on the independence in both appearance and fact of the registered public accounting firm;
c. the substance of the registered accounting firm's discussion with the audit committee.

4.4 Assertion of Internal Financial Controls: The Audit Committee should require the auditor's opinion to include commentary on any management assertion that the system of internal financial controls is operating effectively and efficiently, that assets are safeguarded, and that financial information is reliable as of a specific date, based on a specific integrated framework of internal controls.

4.5 Audit Committee Oversight: To ensure the integrity of audited financial statements, the corporation's interaction with the external auditor should be overseen by the audit committee on behalf of shareowners.

4.6 Audit Committee Expertise: Audit committee financial expertise at a minimum should include skill-sets as outlined by Section 407(d)(5)(i) of Regulation S-K and the Exchange listing requirements. Boards should consider the effectiveness of the audit committee and designated financial expert(s) in its annual assessment. Firms may be able to reduce their cost of capital as related to the quality of its financial reporting. The quality of financial reporting can be increased by appropriately structuring the audit committee with effective financial expertise.

4.7 Auditor Liability: To strengthen the auditor's objective and unbiased audit of financial reporting, audit committees should ensure that contracts with the auditor do not contain specific limits to the auditor's liability to the company for consequential damages or require the corporation to use alternative dispute resolution.

4.8 Auditor Selection: Audit committees should promote expanding the pool of auditors considered for the annual audit to help improve market competition and thereby minimize the concentration of only a small number of audit firms from which to engage for audit services. To allow audit committees a robust foundation to determine audit firm independence, auditors should provide 3 prior years of activities, relationships, and services (including tax services) with the company, affiliates of the company and persons in financial reporting oversight roles that may impact the independence of the audit firm.

4.9 Auditor Rotation: Audit committees should promote rotation of the auditor every 5 – 7 years to ensure a fresh perspective and review of the financial reporting framework.

5 Corporate Responsibility

Shareowners can be instrumental in encouraging responsible corporate citizenship. CalPERS believes that environmental, social, and corporate governance issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, and asset classes through time.) Therefore, CalPERS joined 19 other institutional investors from 12 countries to develop and become a signatory to The Principles for Responsible Investment (Appendix D).

CalPERS expects companies whose equity securities are held in the Fund's portfolio to conduct themselves with propriety and with a view toward responsible corporate conduct. If any improper practices come into being, companies should move decisively to eliminate such practices and affect adequate controls to prevent recurrence. A level of performance above minimum adherence to the law is generally expected. To further these goals, in September 1999 the CalPERS Board adopted the Global Sullivan Principles of Corporate Social Responsibility.

CalPERS believes that boards that strive for active cooperation between corporations and stakeholders[15] will be most likely to create wealth, employment and sustainable economies. With adequate, accurate and timely data disclosure of environmental, social, and governance practices, shareowners are able to more effectively make investment decisions by taking into account those practices of the companies in which the Fund invests. Therefore, CalPERS recommends that:

5.1 Human Rights Violations: Corporations adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates. Adherence to a formal set of principles such as those exemplified in Appendix E, the Global Sullivan Principles[16], or the human rights and labor standards principles exemplified in Appendix F by the United Nations Global Compact[17], is recommended.

5.2 Environmental Disclosure: To ensure sustainable long-term returns, companies should provide accurate and timely disclosure of environmental risks and opportunities through adoption of policies or objectives, such as those associated with climate change. Companies should apply the Global Framework for Climate Risk Disclosure[18] (Appendix ~~F~~G) when providing such disclosure. The 14 point Ceres Climate Change Governance Checklist (Appendix ~~G~~H) is recommended as a tool by companies to assist in the application of the Global Framework for Climate Risk Disclosure.

5.3 Sustainable Corporate Development: Corporations strive to measure, disclose, and be accountable to internal and external stakeholders for organizational performance towards the goal of sustainable development. It is recommended that corporations adopt the Global Reporting Initiative Sustainability Reporting Guidelines[19] to disclose economic, environmental, and social impacts.

5.4 Reincorporation: When considering reincorporation, corporations should analyze shareowner protections, company economic, capital market, macro economic, and corporate governance considerations.

6 Shareowner Rights

Shareowner rights[20] – or those structural devices that define the formal relationship between shareowners and the directors to whom they delegate corporate control – should be featured in the governance principles adopted by corporate boards. Therefore, CalPERS recommends that corporations adopt the following corporate governance principles affecting shareowner rights:

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[15] In accordance with the Global Reporting Initiative: Stakeholders are defined broadly as those groups or individuals: (a) that can reasonably be expected to be significantly affected by the organization's activities, products, and/or services; or (b) whose actions can reasonably be expected to affect the ability of the organization to successfully implement its strategies and achieve its objectives.

[16] CalPERS adopted the Global Sullivan Principles of Corporate Social Responsibility in September 1999.

[17] The United Nations Global Compact is a framework for businesses that are committed to aligning their operations and strategies with ten principles in the areas of human rights, labor, the environment and anti-corruption.

[18] Additional information on the Framework and a Guide for Using the Global Framework for Climate Risk Disclosure is available on the CalPERS website: www.calpers-governance.org.

[19] Adoption of the Guidelines will provide companies with a reporting mechanism through which to disclose, at a minimum, implementation of the Global Sullivan Principles and the Global Framework for Climate Risk Disclosure. The Guidelines along with additional information on GRI can be found at www.globalreporting.org.

[20] Lucian Bebchuk, Alma Cohen, and Allen Ferrell, "What matters in Corporate Governance," (2004), The John M. Olin Center for Law, Economics and Business of Harvard University: Found that portfolios of companies with strong shareowner-rights protections outperformed portfolios of companies with weaker protections by 8.5% per year.

6.1 Majority Vote Requirements: Shareowner voting rights should not be subject to supermajority voting requirements. A majority of proxies cast should be able to:

a. Amend the company's governing documents such as the Bylaws and Charter by shareowner resolution.
b. Remove a director with or without cause.

6.2 Majority Vote Standard for Director Elections: In an uncontested director election, a majority of proxies cast should be required to elect a director. In a contested election, a plurality of proxies cast should be required to elect a director. Resignation for any director that receives a withhold vote greater than 50% of the votes cast should be required. Unless the incumbent director receiving less than a majority of the votes cast has earlier resigned, the term of the incumbent director should not exceed 90 days after the date on which the voting results are determined.

6.3 Special Meetings and Written Consent: Shareowners should be able to call special meetings or act by written consent.

6.4 Sponsoring and Implementation of Shareowner Resolutions: Shareowners should have the right to sponsor resolutions. A shareowner resolution that is approved by a majority of proxies cast should be implemented by the board.

6.5 Prohibit Greenmail: Every company should prohibit greenmail.

6.6 Poison Pill Approval: No board should enact nor amend a poison pill except with shareowner approval.

6.7 Annual Director Elections: Every director should be elected annually.

6.8 Proxy Confidentiality: Proxies should be kept confidential from the company, except at the express request of shareowners.

6.9 Broker Non-Votes: Broker non-votes should be counted for quorum purposes only.

6.10 Cumulative Voting Rights: Shareowners should have the right to cumulate[21] votes in a contested election of directors.

C. International Principles of Accountable Corporate Governance

For companies that are not domiciled in the United States nor trade on U.S. stock exchanges, CalPERS advocates the expansion of the Core Principles into the International Corporate Governance Network ("ICGN") Corporate Governance Principles. As a founding member of ICGN, CalPERS believes the ICGN Principles represent an evolving framework for accountable corporate governance to be applied outside of the United States. In addition to encouraging portfolio companies to adopt these principles, CalPERS implements its international corporate governance initiatives and proxy voting responsibilities in a manner that is consistent the following ICGN Principles:

The ICGN Principles[22] are as follows:

1. <u>Corporate Objective – Shareowner Returns</u>

[21] Such a right gives shareowners the ability to aggregate their votes for directors and either cast all of those votes for one candidate or distribute those votes for any number of candidates.

[22] The ICGN Corporate Governance Principles were revised July 8, 2005 at the annual conference in London, UK.

1.1 Optimizing Return to Shareowners: The overriding objective of the corporation should be to optimize over time the returns to its shareowners. Corporate governance practices should focus board attention on this objective. In particular, the company should strive to excel in comparison with the specific equity sector peer group benchmark. Where other considerations affect this objective, they should be clearly stated and disclosed.

1.2 Long Term Prosperity of the Business: To achieve this objective, the board should develop and implement a strategy for the corporation which improves the equity value over the long term.

2. Disclosure & Transparency

2.1 Objective: Corporations should disclose relevant and material information concerning the corporation on a timely basis, in particular meeting market guidelines where they exist, so as to allow investors to make informed decisions about the acquisition, ownership obligations and rights, and sale of shares.

2.2 Disclosure of Ownership and Voting Rights: In addition to financial and operating results, company objectives, risk factors, stakeholder issuers and governance structures, the information should include a description of the relationship of the company to other companies in the corporate group, data on major shareowners and others that control or may control the company, including information on special voting rights, shareowner agreements, the beneficial ownership of controlling or large blocks of shares, significant cross-shareholding relationships and cross-guarantees as well as information on differential voting rights and related party transactions.

3. Audit

3.1 Accounting Principles: The ICGN supports the development of the highest-quality international accounting and financial reporting standards. The ICGN also supports the harmonization of such standards and encourages corporations to apply those or other standards of comparable quality.

3.2 Audit Independence: Annual audits of the financial statements carried out on behalf of shareowners should be required for all corporations. The audit should be carried out by independent, external auditors who should be proposed by or with the assistance of, the audit committee of the board (or its equivalent where applicable) for approval by shareowners. The corporation's interaction with the external auditor should be overseen by the audit committee on behalf of the shareowners. To limit the risk of possible conflicts of interest, non-audit services and fees paid to auditors for non-audit services should be both approved in advance by the audit committee and disclosed in the annual report.

3.3 Annual Audit: The annual audit should provide an external and objective opinion that the financial statements fairly represent the financial position and performance of the company in all material respects, give a true and fair view of the affairs of the company and are in compliance with applicable law and regulations as appropriate.

3.4 Scope of Audit: The scope of the audit will be as prescribed by applicable law, provided that shareowners should have the right to expand the scope of the audit.

3.5 Approval of Financial Statements and Internal Controls: The board of directors, and where required, the appropriate officers of the corporation should affirm on a regular basis (at least annually), the accuracy of the company's financial statements or financial accounts, as appropriate, and the adequacy of its internal controls.

4. Shareowners' Ownership, Responsibilities, Voting Rights, and Remedies

4.1 Shareowner Ownership Rights: The exercise of ownership rights by all shareowners should be facilitated, including giving shareowners reasonable notice of all matters in respect of which shareowners are required to or may take action in the exercise of voting rights.

4.2 Protections: Boards should treat all corporations' shareowners equitably and should ensure that the rights of all investors, including minority and foreign shareowners, are protected.

4.3 Unequal Voting: Corporations' ordinary shares should feature one vote for each share. Corporations should act to ensure the owners' rights to vote. Divergence from a 'one-share, one-vote' standard which gives certain shareowners power disproportionate to their equity ownership should be both disclosed and justified.

4.4 Access to the Vote: The right and opportunity to vote at shareowner meetings hinges in part on the adequacy of the voting system. Markets and companies should facilitate access to the ballot by following the ICGN's *Global Share Voting Principles*. In particular, the ICGN supports initiatives to expand voting options to include the secure use of telecommunication and other electronic channels.

4.5 Shareowner Participation in Governance: Shareowners should have the right to participate in key corporate governance decisions, including the right to nominate, appoint and remove directors on an individual basis as well as the external auditor and the right to approve major decisions of the nature referred to in Section 4.9. Jurisdictions which do not have laws enabling the appointment and removal of a director or an external auditor by shareowners holding a majority of votes should enact them. Companies incorporated in such jurisdictions should nevertheless strive to provide such rights to shareowners.

4.6 Shareowners Right to Call a Meeting of Shareowners: Every corporation should provide owners of a specified portion of the outstanding shares of a corporation, not greater than ten percent (10%), with the right to call a meeting of shareowners for the purpose of transacting the legitimate business of the corporation.

4.7 Shareowner Resolutions: Jurisdictions should enact laws which provide shareowners with the right to put resolutions to a shareowners meeting which may be either advisory to the board of directors or may be binding upon the board of directors depending upon the criteria which must be satisfied by the shareowners putting the resolution.

4.8 Shareowner Questions: Shareowners should be provided with the right to ask questions of the board, management and the external auditor at meetings of shareowners, including questions relating to the board and questions relating to the annual external audit. In addition, shareowners should have the right to receive and discuss the annual audited financial statements of the corporation.

4.9 Major Decisions: Major changes to the core businesses of a corporation and other major corporate changes which may in substance or effect materially dilute the equity or erode the economic interests or share ownership rights of existing shareowners, including major acquisitions and major dispositions and closures of businesses, should not be made without prior shareowner approval of the proposed change. The equity component of compensation schemes for board members and employees should be subject to shareowner approval. Further, corporations should not implement shareowner rights plans or so called "poison pills" without shareowner approval. In addition, changes to the articles or by-laws of the corporation should not be made without prior shareowner approval. Shareowners should be given sufficient information about any such corporate changes, in sufficient time to allow them to make informed judgments and exercise their voting rights.

4.10 Duty to Vote: Corporate voting systems should be designed to enable institutional investors to discharge their fiduciary obligation to vote their shares, recognizing the duty of institutional investors to vote their shares responsibly, wherever practicable. Similarly, regulations and laws should facilitate voting rights and should eliminate impediments to cross-border voting.

4.11 Institutional Shareowner Responsibilities: Institutional investors should discharge their responsibilities as shareowners as set out in the ICGN Statement on Institutional Shareowner Responsibilities.

4.12 Consultation amongst Institutional Shareowners: Jurisdictions which do not have laws allowing institutional investors to consult on issues concerning their basic shareowner rights should enact such laws.

4.13 Vote Execution: Votes cast by intermediaries should be cast only in accordance with the instructions of the beneficial owner or his or her authorized agent.

4.14 Record of Ownership of a Corporation's Shares: Every corporation shall maintain a record of the registered owners of its shares and every corporation should be entitled to require such registered owners to provide the corporation with the identity of beneficial owners if the registered owner is not the beneficial owner. Jurisdictions which do not give corporations the right to require registered owners to provide the corporation with the identity of beneficial owners if the registered owner is not the beneficial owner are encouraged to enact laws which give corporations such rights. Corporations should also be entitled to know the identity of the person authorized to vote shares, if that right is exercised by a person other than the registered owner.

4.15 Disclosing Voting Results: Equal effect should be given to votes whether cast in person or in absentia and meeting procedures should ensure that votes are properly counted and recorded. Corporations should make a timely announcement of the outcome of a vote and to implement this recommendation, corporations should publish voting levels for each resolution forthwith following the meeting.

4.16 Shareowner Rights of Action: Shareowners should be afforded rights of action and remedies which are readily accessible in order to redress conduct of a corporation which treats them inequitably. In addition, minority shareowners should be afforded protection and remedies against abusive or oppressive conduct. Jurisdictions with systems of justice which do not effectively afford shareowners the foregoing rights should facilitate the development of alternative mechanisms for the resolution of disputes involving inequitable, abusive or oppressive treatment of shareowners.

5. Corporate Boards

These Principles do not advocate any particular board structure and the term "board" as used in this document is meant to embrace the different national models of board structures. In the typical two-tier system, "board" as used in the Principles refers to the "supervisory board" while "key executives" refers to the "management board". Although not totally appropriate terminology for a supervisory board in the context of a two-tier board, the term "director" is used to be interchangeable with the term "board member".

5.1 Duties of the Board: The board's duties and responsibilities and key functions, for which they are accountable, include those set out below:

i. Reviewing, approving and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
ii. Monitoring the effectiveness of the company's governance practices and making changes as needed to ensure the alignment of the corporation's governance system with current best practices.
iii. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
iv. Aligning key executive and board remuneration with the longer term interests of the company and its shareowners.
v. Ensuring a formal and transparent board nomination and election process.
vi. Monitoring and managing potential conflicts of interest of management, board members, shareowners, external advisors and other service providers, including misuse of corporate assets and abuse in related party transactions.
vii. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in

particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

viii. Overseeing the process of disclosure and communications.

5.2 Director Competencies: The board should ensure that it is made up of directors with the requisite range of skills, knowledge and experience to enable it to discharge its duties and responsibilities.

5.3 Directors are Fiduciaries: Members of the boards of directors or supervisory boards are fiduciaries who must act in the best interests of all of the shareowners or in the best interests of the corporation and are accountable to the shareowner body as a whole. As fiduciaries, directors owe a duty of loyalty to the corporation and must exercise reasonable care in relation to their duties as directors.

5.4 Independent-Minded Directors: One of the principle features of a well-governed corporation is the exercise by its board of directors of independent judgment. Independent judgment means judgment in the best interests of the corporation free of any external influence that may attempt to be or may be or may appear to be exerted on any individual director or the board as a whole.

5.5 Factors Affecting Independence: A common source of influence arises from a relationship which a director has with the corporation, such as a consulting agreement. The potential influence arises because the contract may have been awarded by management. In addition, a significant shareowner may attempt to influence the judgment of a director in the interests of a significant shareowner rather than in the interests of the corporation. Individual directors with relationships to management or to a significant shareowner are by definition not considered to be independent; however, the absence of such relationships does not guarantee independent judgment.

5.6 Disclosing the Meaning of Independence: These Principles do not offer a comprehensive definition of an “independent director.” Such definitions vary from jurisdiction to jurisdiction and reflect different approaches to the drafting of codes of governance. These Principles simply underline the importance of all directors being independent-minded which means exercising objective judgment in the best interests of the corporation in all circumstances regardless of the consequences which such judgment may have for the director personally. However, every corporation should disclose its definition of independence (which should be at least as strict as the requirements of applicable law) and should disclose its determination as to each member of its board of directors whether such member is independent.

5.7 Independent Board Members: Each board should include a strong presence of independent non-executive directors with appropriate competencies including key industry sector knowledge and experience.

5.8 Non-Executive Non-Independent Board Members: Each board may also include a minority of directors who are non-executive directors and who are not independent but who may nevertheless effectively discharge their responsibilities as directors because of, amongst other things, a relationship with the corporation or past experience with the corporation.

5.9 Information on Board Members: Corporations should disclose upon nomination or appointment to the board and thereafter in each annual report or proxy statement information on the identities, core competencies, professional or other backgrounds, recent and current board and management mandates at any other corporations, factors affecting independence, board and committee meeting attendance and overall qualifications of board members and nominees so as to enable investors to weigh the value they add to the company. Information on the appointment procedure should also be disclosed annually.

5.10 Election of Directors: Each director should stand for election on a regular basis and, in any event, at least once every three years and shareowners should be entitled to vote on the election of each director separately.

5.11 Board Chairs: The chair of the board should neither be the CEO nor a former CEO and should be independent on the date of appointment as chair and should not participate in executive compensation plans. The corporation should explain the reasons, if this is not the case, and in such event should adopt an appropriate alternative structure to ensure that the board responsibilities can be effectively discharged in all circumstances, for example by appointing a deputy chair who is independent.

5.12 Board Committees: Where committees of the board are established, their remit, composition, accountability and working procedures should be well-defined and disclosed by the board.

5.13 Independent Committees: All corporations should establish the key committees of the board which include the audit, compensation and nomination/governance committees. At least a majority and, preferably all members of the audit committee should be independent. The compensation and nomination/governance committees should be composed of a majority of independent directors.

5.14 Related Party Transactions: Every corporation should have a process for reviewing and monitoring any related party transaction. Typically, a committee of independent directors should review every related party transaction to determine whether such transaction is in the best interests of the corporation and if so, ensure that the terms of such transaction are fair to the corporation. The corporation should disclose details of all material related party transactions in the annual report of the corporation.

5.15 Director Conflicts of Interest: Corporations should have a process for identifying and managing conflicts of interest directors may have. If a director has an interest in a matter under consideration by the board, then the director and the board should follow that process.

5.16 Board Evaluation: Every board of directors should evaluate its performance and the performance of individual directors on a regular basis and should consider engaging an outside consultant to assist in the process. Every corporation should disclose the process for such evaluation.

5.17 Non-Executive Director Meeting: Non-executive directors should meet in the absence of executives of the corporation as often as required and on a regular basis.

5.18 Share Ownership: Every corporation should have and disclose a policy concerning ownership of shares of the corporation by senior managers and directors with the objective of aligning the interests of the senior managers and directors with the interests of shareowners in a meaningful way.

6. Corporate Remuneration Policies

6.1 Aligning Remuneration with the Interests of Shareowners: Corporations should follow the best practices for remuneration set out in the most current policy (Appendix ~~H~~I) of the ICGN.

7. Corporate Citizenship, Stakeholder Relations and the Ethical Conduct of Business

7.1 Board Responsibilities and Duties in Relation to Stakeholders: The board is accountable to shareowners and responsible for managing successful and productive relationships with the corporation's stakeholders. The ICGN concurs in the view that active cooperation between corporations and stakeholders is essential in creating wealth, employment and financially-sound enterprises over time.

7.2 Compliance with Laws: Corporations should adhere to all applicable laws of the jurisdictions in which they operate.

7.3 Disclosure of Policies: Corporations should disclose their policies on issues involving stakeholders[23].

7.4 Employee Participation: Corporations are encouraged to develop performance-enhancing mechanisms which align employee interests with shareowner and other stakeholder interests. These include broad-based employee share ownership plans or other profit-sharing programs that are designed to enable employees to share in improved returns to shareowners.

7.5 Corporate Social Responsibility: Corporations should adopt and effectively implement a code of ethics and should conduct their activities in an economically, socially and environmentally responsible manner[24].

7.6 Integrity: The board is responsible for determining, implementing and maintaining a culture of integrity.

8. Corporate Governance Implementation

8.1 Compliance with and Disclosure of Governance Codes and Systems: Corporations should comply with a widely recognized national corporate governance code which is generally in line with these ICGN Principles. Where such a code does not exist, investors and others should endeavor to develop a code. Where the ICGN Principles are more rigorous than those of national codes, companies are encouraged to adopt the ICGN Principles. Each corporation should disclose the code that is applicable to it, whether it is complied with and, where not, the reasons for non-compliance. Institutional investors should give due and informed consideration to explanations given by corporation for such non-compliance.

8.2 Resolution of Governance Issues: Corporate governance issues between shareowners, the board, and management should be addressed through dialogue and, where appropriate, with government and regulatory representatives as well as other concerned bodies, so as to resolve disputes, if possible, through negotiation, mediation or arbitration. Where those means fail, more forceful actions should be available. For instance, investors should have the right to sponsor resolution and/or convene extraordinary meetings.

D. Emerging Markets Principles of Accountable Corporate Governance

CalPERS advocates the expansion of the Core Principles by companies in emerging markets into the Emerging Markets Principles of Accountable Corporate Governance.

Shareowners can be instrumental in encouraging responsible corporate citizenship. CalPERS believes that environmental, social, and corporate governance issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, and asset classes through time.) Therefore, CalPERS joined 19 other institutional investors from 12 countries to develop and become a signatory to The Principles for Responsible Investment (Appendix D).

CalPERS expects developed and emerging economy companies whose equity securities are held in the Fund's portfolio to conduct themselves with propriety and with a view toward responsible corporate conduct. If any improper practices come into being, companies should move decisively to eliminate such practices and effect adequate controls to prevent recurrence. A level of performance above minimum adherence to the law is generally expected. CalPERS believes that Boards that strive for

[23] CalPERS recommends that corporations adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates.

[24] CalPERS recommends that corporations adopt the Global Reporting Initiative Sustainability Reporting Guidelines to disclose economic, environmental, social, and governance impacts.

active cooperation between corporations and stakeholders[25] will be most likely to create wealth, employment and sustainable economies.

CalPERS recognizes that adopting formal corporate governance principles, such as the ICGN Principles in its entirety, may not be appropriate for every company in emerging capital markets. However, with adequate, accurate, and timely disclosure of environmental, social, and governance practices, investors are able to more effectively make investment decisions by taking into account those practices.

Good governance and sustainable development are mutually achievable. While companies in emerging markets should strive to meet the governance practices presented by the ICGN Principles, CalPERS recommends those emerging markets companies focus first and foremost on adopting the Core Principles with emphasis on practices that promote sustainable economic, environmental, social, and governance development. Thus, companies in emerging capital markets should formalize a reporting mechanism by which sustainable development practices can be disclosed to stakeholders, including shareowners.

CalPERS recommends:

1. **Sustainable Long-Term Value Creation:** Companies should adopt corporate reporting guidelines, such as the Global Reporting Initiative Sustainability Reporting Guidelines[26] in order to measure, disclose, and be accountable to internal and external stakeholders for organizational performance towards the goal of sustainable long-term value creation. Disclosure reporting guidelines should include:

    a. The effect of economic, environmental, social and governance impacts, risks and opportunities related to the company's stakeholders.

    b. Activities the company is undertaking to protect shareowner rights and investment capital within its local emerging market.

2. **Eliminating Human Rights Violations:** Adopt maximum progressive practices toward the elimination of human rights violations. Adherence to a formal set of principles such as those exemplified in Appendix E, the Global Sullivan Principles or the human rights and labor standards principles exemplified by the United Nations Global Compact, is recommended.

E. Joint Venture Governance

Shareowners have a direct interest in the returns, risks, and governance of all wholly- and partly-owned assets that make up public companies. To date, the focus of CalPERS efforts on governance, and that of regulators and investors, has been on wholly-owned business units, subsidiaries, and affiliates of public companies. CalPERS believes that ensuring the effective governance of material equity joint ventures – a key asset class with well-documented and unique performance challenges where there has been historically less transparency than for similar-sized wholly owned businesses – is also an essential part of effective corporate governance.

To enhance investor confidence and to raise performance, CalPERS believes that companies need to raise the level of transparency, accountability, and discipline in the governance of their material joint ventures. As a minimum, any joint venture accounting for 10 percent or more of a publicly-traded parent company's total assets, invested capital, costs or revenues – or that is expected to account for

[25] In accordance with the Global Reporting Initiative: Stakeholders are defined broadly as those groups or individuals: (a) that can reasonably be expected to be significantly affected by the organization's activities, products, and/or services; or (b) whose actions can reasonably be expected to affect the ability of the organization to successfully implement its strategies and achieve its objectives.

[26] Adoption of the Guidelines will provide companies with a reporting mechanism through which to disclose economic, environmental, social, and governance practices. The Guidelines along with additional information on GRI can be found at www.globalreporting.org.

10 percent of the profit and loss of the corporation – should be viewed as material, as should smaller joint ventures that are strategically important, or that carry disproportionate risks. We believe that companies may wish to adopt a more inclusive standard for materiality, and, for instance, draw the line at joint ventures at or above $500 million in annual revenues or invested capital.

For this class of joint ventures, CalPERS believes that the Company Board – i.e., the Board of parent companies that have ownership interests in joint ventures – should ensure the adoption of certain practices related to these joint ventures:

1. **Corporate-Level Joint Venture Governance Practices**. For any publicly-held company with one or more material joint ventures, that parent company should:

   1.1 Require that the Audit Committee of the Company Board annually review the governance integrity and compliance policies of the company's material joint ventures[27]

   1.2 Designate a Corporate Board member to be responsible for ensuring that the Company's corporate-level strategic business review process includes the Company's material joint ventures, and this review process holds joint ventures to similar performance standards to one another and to similar-sized business units[28]

   1.3 Adopt and make available to the public a set of Joint Venture Governance Guidelines for the Company's material joint ventures (such as those in Appendix I, co-authored by CalPERS and Water Street Partners) which define a set of minimum expectations for overseeing such ventures

   1.4 Designate a Corporate Board member to be responsible for ensuring, on an annual basis, that the Company's material joint ventures are subject to a review of their adherence to these Joint Venture Governance Guidelines, and that the results of the review are discussed and approved by the Corporate Board[29]

2. **Public Disclosure and Transparency.** For any material joint venture that has at least one public company shareholder, that parent company should disclose to its public investors[30]:

   2.1 The name, business scope and objectives, and current financial impact of each material joint venture of the Company

   2.2 A list of the Lead Director of the Joint Venture Board of Directors of each material joint venture

   2.3 Whether each material joint venture is complying with the guidelines outlined in Appendix I; to the extent that the venture is not meeting any of these governance standards, provide an explanation for why such governance standards are not being met[31]

[27] Such a review would likely include: i) corporate audit processes, ii) financial reporting, iii) training and compliance programs, and iv) (potentially) Sarbanes Oxley compliance issues for large joint ventures. Note: this Audit Committee review is not intended as a broad-based strategic performance review of individual ventures, but a fact-based conversation about the corporate-level policies and implementation status of various controls related to joint ventures.

[28] It is the experience of the authors that joint ventures – even billion-dollar joint ventures – are routinely left outside the regular corporate-level review process, and are therefore not subject to the same "challenge process" or "restructuring conversations" as wholly-owned business units, which, in turn, drives financial underperformance.

[29] This Board member may be the Chair of the Audit Committee (and thus link the JV Governance Guidelines into the broader JV compliance and financial integrity review process as described in 1.1), or the same individual as named in 1.2 above.

[30] This applies irrespective of the parent company's equity ownership interest in the venture, or whether the parent company consolidates to joint ventures on its financial statements

[31] Such a "comply and explain" approach - i.e., require that public companies disclose whether they are complying with a set of minimums and, if not, why – has been used in a number of corporate governance situations. For instance, in adopting the Cadbury Code (UK corporate governance guidelines similar to CalPERS' guidelines in the US), the London Stock Exchange asked that listed companies reveal in their annual reports whether they were

IV. CONCLUSION

By adopting the Global Principles of Accountable Corporate Governance, CalPERS strives to advance corporate governance best practices for the purpose of creating sustainable long-term investment returns and protecting the System's rights as a shareowner. CalPERS encourages other investors to incorporate these Global Principles into ownership policies and practices as a basis for advancing a foundation for accountability between a corporation's board of directors, management and its owners. With continued experience and communication between the board, corporate managers and owners, the issue of accountability can become – if not resolved – more clear.

> *"As conflict – difference – is here in the world, as we cannot avoid it, we should, I think, use it. Instead of condemning it, we should set it to work for us… So in business, we have to know when to … try to capitalize [on conflict], when to see what we can make it do…. [In that light] it is possible to conceive of conflict as not necessarily a wasteful outbreak of incompatibilities but a normal process by which socially valuable differences register themselves for the enrichment of all concerned…. Conflict at the moment of the appearing and focusing of difference may be a sign of health, a prophecy of progress."*

THE PRICE WATERHOUSE CHANGE INTEGRATION TEAM, THE PARADOX PRINCIPLES 275 (quoting Mary Parker Follett) (1996).

complying with it – and if not, why. We believe that this is a powerful alternative to a "corporate requirement" in JV situations, creating better governance behaviors while also allowing for flexibility across different ventures operating under different circumstances.

APPENDIX A

The Council of Institutional Investors Corporate Governance Policies[32]

The Council of Institutional Investors is the premier U.S. shareowner-rights organization. It is a not-for-profit association of 130 public, labor, and corporate pension funds with assets exceeding $3 trillion. The Council works to educate members and the public about corporate governance, and to advocate for strong governance standards on issues ranging from executive compensation to the election of corporate directors.

COUNCIL OF INSTITUTIONAL INVESTORS

The Council of Institutional Investors Corporate Governance Policies

CONTENTS:

1. **Introduction**
2. **The Board of Directors**
3. **Shareowner Voting Rights**
4. **Shareowner Meetings**
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7. **Independent Director Definition**

1. Introduction

1.1 Nature and Purpose of the Council's Corporate Governance Policies
1.2 Federal and State Law Compliance
1.3 Disclosed Governance Policies and Ethics Code
1.4 Accountability to Shareowners
1.5 Shareowner Participation
1.6 Business Practices and Corporate Citizenship
1.7 Governance Practices at Public and Private Companies
1.8 Reincorporation

1.1 Nature and Purpose of the Council's Corporate Governance Policies: Council policies neither bind members nor corporations. They are designed to provide guidelines that the Council has found to be appropriate in most situations.

[32] Updated and approved by CII General Membership in September, 2007.

1.2 Federal and State Law Compliance: The Council expects that corporations will comply with all applicable federal and state laws and regulations and stock exchange listing standards.

1.3 Disclosed Governance Policies and Ethics Code: The Council believes every company should have written disclosed governance procedures and policies, an ethics code that applies to all employees and directors, and provisions for its strict enforcement. The Council posts its corporate governance policies on its web site (www.cii.org); it hopes corporate boards will meet or exceed these standards and adopt similarly appropriate additional policies to best protect shareowners' [33] interests.

1.4 Accountability to Shareowners: In general, the Council believes that corporate governance structures and practices should protect and enhance accountability to, and ensure equal financial treatment of, shareowners. An action should not be taken if its purpose is to reduce accountability to shareowners.

1.5 Shareowner Participation: The Council believes shareowners should have meaningful ability to participate in the major fundamental decisions that affect corporate viability, and meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation.

1.6 Business Practices and Corporate Citizenship: The Council believes companies should adhere to responsible business practices and practice good corporate citizenship. Promotion, adoption and effective implementation of guidelines for the responsible conduct of business and business relationships are consistent with the fiduciary responsibility of protecting long-term investment interests.

1.7 Governance Practices at Public and Private Companies: The Council believes good governance practices should be followed by publicly traded companies, private companies and companies in the process of going public. As such, the Council believes that, consistent with their fiduciary obligations to their limited partners, the general members of venture capital, buyout and other private equity funds should use appropriate efforts to encourage companies in which they invest to adopt long-term corporate governance provisions that are consistent with the Council's policies.

1.8 Reincorporation: The Council believes that U.S. companies should not reincorporate offshore because corporate governance structures there are weaker and therefore reduce management accountability to shareowners.

2. The Board of Directors

2.1 Annual Election of Directors
2.2 Director Elections
2.3 Independent Board
2.4 All-independent Board Committees
2.5 Board Accountability to Shareowners
2.6 Board/Director Evaluation
2.7 "Continuing Directors"
2.8 Board Size and Service
2.9 Board Operations

[33] At the February 2006 meeting of the Council's Policies Committee, it was decided that Council policies should use the term "shareowner" instead of "shareholder," reflecting the Council's belief that the former term is a better descriptor.

2.10 Auditor Independence
2.11 Charitable and Political Contributions

2.1 Annual Election of Directors: All directors should be elected annually (no classified boards).

2.2 Director Elections: When permissible under state law, companies' charters and by-laws should provide that directors in uncontested elections are to be elected by a majority of the votes cast. In contested elections, plurality voting should apply. An election is contested when there are more director candidates than there are available board seats. Boards should adopt policies asking that directors tender their resignations if they fail to win majority support in uncontested elections, and providing that such directors will not be renominated after expiration of their current term in the event they fail to tender such resignation.

2.3 Independent Board: At least two-thirds of the directors should be independent (i.e., their only non-trivial professional, familial or financial connection to the corporation, its chairman, CEO or any other executive officer is their directorship). The company should disclose information necessary for shareowners to determine whether directors qualify as independent, whether or not the disclosure is required by state or federal law. This information should include all financial or business relationships with and payments to directors and their families and all significant payments to companies, non-profits, foundations and other organizations where company directors serve as employees, officers or directors. (See Council definition of independent director.)

2.4 All-independent Board Committees: Companies should have audit, nominating and compensation committees, and all members of these committees should be independent. The board (not the CEO) should appoint the committee chairs and members. Committees should be able to select their own service providers. Some regularly scheduled committee meetings should be held with only the committee members (and, if appropriate, the committee's independent consultants) present. The process by which committee members and chairs are selected should be disclosed to shareowners.

2.5 Board Accountability to Shareowners

2.5.1 Majority Shareowner Votes: Boards should take actions recommended in shareowner proposals that receive a majority of votes cast for and against. If shareowner approval is required for the action, the board should submit the proposal to a binding vote at the next shareowner meeting.

2.5.2 Interaction with Shareowners: Directors should respond to communications from shareowners and should seek shareowner views on important governance, management and performance matters. All directors should attend the annual shareowners' meeting and be available, when requested by the chair, to answer shareowner questions.

2.5.3 Shareowner-director Communication, Interaction & Meeting Conduct: Directors should respond to communications from shareowners and should seek shareowner views on important governance, management and performance matters. To accomplish this goal, all companies should establish a mechanism by which shareowners with non-trivial concerns could communicate directly with all directors, including independent directors. Policies requiring that all director communication go through a member of the

management team should be avoided unless they are for record-keeping purposes. In such cases, procedures documenting receipt, delivery to the board and response must be maintained and made available upon request to shareowners.

During the annual general meeting, shareowners should have the right to ask questions, both orally and in writing, and expect answers and discussion where appropriate from the board of directors. Such discussion should take place regardless whether those questions have been submitted in advance. All directors should attend the annual shareowners' meetings and be available, when requested by the chair, to answer shareowner questions. While reasonable time limits to questions asked might be acceptable, the board should not ignore or skip hearing questions because a shareowner has a smaller number of shares or has not held those shares for a certain amount of time.

2.5.4 Independent Chair/Lead Director: The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interests of shareowners, and it should name a lead independent director who should have approval over information flow to the board, meeting agendas, and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.
Other roles of the lead independent director should include chairing meetings of non-management directors and of independent directors, presiding over board meetings in the absence of the chair, serving as the principle liaison between the independent directors and the chair, and leading the board/director evaluation process. Given these additional responsibilities, the lead independent director should expect to devote a greater amount of time to board service than the other directors.

2.6 Board/Director Evaluation

2.6.1 Nature of Evaluation: Boards should evaluate themselves and their individual members on a regular basis. Board evaluation should include an assessment of whether the board has the necessary diversity of skills, backgrounds, experiences, ages, races and genders appropriate to the company's ongoing needs. Individual director evaluations should include high standards for in-person attendance at board and committee meetings and disclosure of all absences or conference call substitutions.

2.6.2 Evaluation of Directors From Whom at Least 10 Percent of the Votes Cast are Withheld: Boards should review the performance and qualifications of any director from whom at least 10 percent of the votes cast are withheld.

2.6.3 Board and Committee Meeting Attendance: Absent compelling and stated reasons, directors who attend fewer than 75 percent of board and board-committee meetings for two consecutive years should not be renominated. Companies should disclose individual director attendance figures for board and committee meetings. Disclosure should distinguish between in-person and telephonic attendance. Excused absences should not be categorized as attendance.

2.7 "Continuing Directors": Corporations should not adopt so-called "continuing director" provisions (also known as "dead-hand" poison pills) that allow former directors who have left office to take action on behalf of the corporation.

2.8 Board Size and Service: Absent compelling, unusual circumstances, a board should have no fewer than 5 and no more than 15 members (not too small to maintain the needed expertise and independence, and not too large to be efficiently functional). Shareowners should be allowed to vote on any major change in board size.

Companies should establish and publish guidelines specifying on how many other boards their directors may serve. Absent unusual, specified circumstances, directors with full-time jobs should not serve on more than two other boards. Currently serving CEOs should only serve as a director of one other company, and then only if the CEO's own company is in the top half of its peer group. No person should serve on more than five for-profit company boards.

2.9 Board Operations

2.9.1 Informed Directors: Directors should receive training from independent sources on their fiduciary responsibilities and liabilities. Directors have an affirmative obligation to become and remain independently familiar with company operations; they should not rely exclusively on information provided to them by the CEO to do their jobs. Directors should be provided meaningful information in a timely manner prior to board meetings, and should be allowed reasonable access to management to discuss board issues.

2.9.2 Director Rights Regarding Board Agendas: Directors should be allowed to place items on board agendas.

2.9.3 Executive Sessions: Non-management directors should hold regularly scheduled executive sessions without the CEO or staff present. The independent directors should also hold regularly scheduled in-person executive sessions without non-independent directors and staff present.

2.9.4 CEO Succession Planning: The board should approve and maintain a CEO succession plan.

2.10 Auditor Independence

2.10.1 Audit Committee Responsibilities Regarding Outside Auditors: As prescribed by law, the audit committee has the responsibility to hire, oversee and, if necessary, fire the company's outside auditor.

2.10.2 Competitive Bids: The audit committee should seek competitive bids for the external audit engagement no less frequently than every five years.

2.10.3 Non-audit Services: The company's external auditor should not perform any non-audit services for the company, except those required by statute or regulation to be performed by a company's external auditor, such as attest services.

2.10.4 Audit Committee Charters: The proxy statement should include a copy of the audit committee charter and a statement by the audit committee that it has complied with the duties outlined in the charter.

2.10.5 Liability of Outside Auditors: Companies should not agree to limit the liability of outside auditors.

2.10.6 Shareowner Votes on Board's Choice of Outside Auditor: Audit committee charters should provide for annual shareowner votes on the board's choice of independent, external auditor. Such provisions ought to state that if the board's selection fails to achieve the support of a majority of the for-and-against votes cast, the audit committee should: (1) take the shareowners' views into consideration and reconsider its choice of auditor; and (2) solicit the views of major shareowners in order to determine why broad levels of shareowner support were not achieved.

2.10.7 Disclosure of Reasons Behind Auditor Changes: The audit committee should publicly provide to shareowners a plain-English explanation of the reasons for a change in the company's external auditors. At a minimum, this disclosure should be contained in the same Securities and Exchange Commission filing that companies are required to submit within four days of an auditor change.

2.11 Charitable and Political Contributions

2.11.1 Board Monitoring, Assessment and Approval: The board of directors should monitor, assess and approve all charitable and political contributions (including trade association contributions) made by the company. The board should ensure that only contributions consistent with and aligned to the interests of the company and its shareowners are approved. The terms and conditions of such contributions should be clearly defined and approved by the board.

2.11.2 Disclosure: The board's guidelines for contribution approval should be publicly disclosed as a corporate contributions policy. The board should disclose on an annual basis the amounts and recipients of all monetary and non-monetary contributions made by the company during the prior fiscal year. If any expenditures earmarked for political or charitable activities were provided to or through a third-party, then those expenditures should be included in the report.

3. <u>Shareowner Voting Rights</u>

3.1 Shareowners' Right to Vote is Inviolate
3.2 Access to the Proxy
3.3 One Share, One Vote
3.4 Confidential Voting
3.5 Voting Requirements
3.6 Broker Votes
3.7 Bundled Voting

3.1 Shareowners' Right to Vote is Inviolate: The shareowners' right to vote is inviolate and should not be abridged.

3.2 Access to the Proxy: Companies should provide access to management proxy materials for a long-term investor or group of long-term investors owning in aggregate at least 5 percent of a company's voting stock to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least three years. Company proxy materials and related mailings should provide equal space and equal treatment of nominations by qualifying investors.

3.3 One Share, One Vote: Each share of common stock should have one vote. Corporations should not have classes of common stock with disparate voting rights. Authorized unissued common shares that have voting rights to be set by the board should not be issued with unequal voting rights without shareowner approval.

3.4 Confidential Voting: All proxy votes should be confidential, with ballots counted by independent tabulators. Confidentiality should be automatic and permanent and apply to all ballot items. Rules and practices concerning the casting, counting and verifying of shareowner votes should be clearly disclosed.

3.5 Voting Requirements: A majority vote of common shares outstanding should be sufficient to amend company bylaws or take other action requiring or receiving a shareowner vote. Supermajority votes should not be required. A majority vote of common shares outstanding should be required to approve:

- Major corporate decisions concerning the sale or pledge of corporate assets that would have a material effect on shareowner value. Such a transaction will automatically be deemed to have a material effect if the value of the assets exceeds 10 percent of the assets of the company and its subsidiaries on a consolidated basis;

- The corporation's acquiring 5 percent or more of its common shares at above-market prices other than by tender offer to all shareowners;

- Poison pills;

- Abridging or limiting the rights of common shares to: (1) vote on the election or removal of directors or the timing or length of their term of office; or (2) make nominations for directors or propose other action to be voted on by shareowners; or (3) call special meetings of shareowners or take action by written consent or affect the procedure for fixing the record date for such action; and

- Provisions resulting in the issuance of debt to a degree that would excessively leverage the company and imperil the long-term viability of the corporation.

3.6 Broker Votes: Broker non-votes and abstentions should be counted only for purposes of a quorum.

3.7 Bundled Voting: Shareowners should be allowed to vote on unrelated issues separately. Individual voting issues, particularly those amending a company's charter, bylaws or anti-takeover provisions, should not be bundled.

4. Shareowner Meetings

4.1 Selection and Notification of Meeting Time and Location
4.2 Record Date and Ballot Item Disclosure

4.3 Election Polls
4.4 Meeting Adjournment and Extension
4.5 Electronic Meetings
4.6 Director Attendance

4.1 Selection and Notification of Meeting Time and Location: Corporations should make shareowners' expense and convenience primary criteria when selecting the time and location of shareowner meetings. Appropriate notice of shareowner meetings, including notice concerning any change in meeting date, time, place or shareowner action, should be given to shareowners in a manner and within time frames that will ensure that shareowners have a reasonable opportunity to exercise their franchise.

4.2 Record Date and Ballot Item Disclosure: To promote the ability of shareowners to make informed decisions regarding whether to recall loaned shares: (1) shareowner meeting record dates should be disclosed as far in advance of the record date as possible; and (2) proxy statements should be disclosed before the record date passes whenever possible.

4.3 Election Polls: Polls should remain open at shareowner meetings until all agenda items have been discussed and shareowners have had an opportunity to ask and receive answers to questions concerning them.

4.4 Meeting Adjournment and Extension: Companies should not adjourn a meeting for the purpose of soliciting more votes to enable management to prevail on a voting item. Extending a meeting should only be done for compelling reasons such as vote fraud, problems with the voting process or lack of a quorum.

4.5 Electronic Meetings: Companies should hold shareowner meetings by remote communication (so-called electronic or "cyber" meetings) only as a supplement to traditional in-person shareowner meetings, not as a substitute.

4.6 Director Attendance: As noted in Section 2, “The Board of Directors,” all directors should attend the annual shareowners’ meeting and be available, when requested by the chair, to respond directly to oral or written questions from shareowners.

5. Executive Compensation

5.1 Introduction
5.2 Advisory Shareowner Votes on Executive Pay
5.3 Role of Compensation Committee
5.4 Salary
5.5 Annual Incentive Compensation
5.6 Long-term Incentive Compensation
5.7 Dilution
5.8 Stock Option Awards
5.9 Stock Awards/Units
5.10 Perquisites
5.11 Employment Contracts, Severance and Change-of-control Payments
5.12 Retirement Arrangements
5.13 Stock Ownership

5.1 Introduction: The Council believes that executive compensation is a critical and visible aspect of a company’s governance. Pay decisions are one of the most direct

ways for shareowners to assess the performance of the board. And they have a bottom line effect, not just in terms of dollar amounts, but also by formalizing performance goals for employees, signaling the market and affecting employee morale.

The Council endorses reasonable, appropriately structured pay-for-performance programs that reward executives for sustainable, superior performance over the "long-term," consistent with a company's investment horizon and generally considered to be five or more years for mature companies and at least three years for other companies. While the Council believes that executives should be well paid for superior performance, it also believes that executives should not be excessively paid. It is the job of the board of directors and the compensation committee to ensure that executive compensation programs are effective, reasonable and rational with respect to critical factors such as company performance, industry considerations and compensation paid to other employees inside the company.

It is also the job of the compensation committee to ensure that elements of compensation packages are appropriately structured to enhance the company's short- and long-term strategic goals and to retain and motivate executives to achieve those strategic goals. Compensation programs should not be driven by competitive surveys, which have become excessive and subject to abuse. They should recognize that it is shareowners, not executives, whose money is at risk.

Since executive compensation must be tailored to meet unique company needs and situations, compensation programs must always be structured on a company-by-company basis. However, the Council believes that certain principles apply to all companies.

5.2 Advisory Shareowner Votes on Executive Pay: All companies should provide annually for advisory shareowner votes on the compensation of senior executives.

5.3 Role of Compensation Committee: The compensation committee is responsible for structuring executive pay, evaluating executive performance within the context of the pay structure of the entire company, subject to approval of the board of directors. To best handle this role, the Council believes that compensation committees should adopt the following principles and practices:

5.3a Committee Composition: All members of the compensation committee should be independent. Committee membership should rotate periodically among the board's independent directors. Members should be or take responsibility to become knowledgeable about compensation and related issues. They should exercise due diligence and independent judgment in carrying out their committee responsibilities. They should represent diverse backgrounds and professional experiences.

5.3b Executive Pay Philosophy: The compensation philosophy should be clearly disclosed to shareowners in annual proxy statements. In developing, approving and monitoring the executive pay philosophy, the compensation committee should consider the full range of pay components, including structure of programs, desired mix of cash and equity awards, goals for distribution of awards throughout the company, how executive pay relates to the pay of other employees, use of employment contracts, and policy regarding dilution.

5.3c **Oversight:** The compensation committee should vigorously oversee all aspects of executive compensation for a group composed of the CEO and other highly paid executives, as required by law, and any other highly paid employees, including executives of subsidiaries, special purpose entities and other affiliates, as determined by the compensation committee. The committee should ensure that the structure of employee compensation throughout the company is fair, non-discriminatory and forward-looking, and that it motivates, recruits and retains a workforce capable of meeting the company's strategic objectives. To perform its oversight duties, the committee should approve, comply with and fully disclose a charter detailing its responsibilities.

5.3d **Pay for Performance:** Compensation of the executive oversight group should be driven predominantly by performance. The compensation committee should establish performance measures for executive compensation that are agreed to ahead of time and publicly disclosed. Performance measures applicable to all performance-based awards (including annual and long-term incentive compensation) should reward superior performance—based predominantly on total stock return measures and key operational measures—at minimum reasonable cost and should reflect downside risk.

5.3e **Annual Approval and Review:** Each year, the compensation committee should review performance of individuals in the oversight group and approve any bonus, severance, equity-based award or extraordinary payment made to them. The committee should understand all components of executive compensation and annually review total compensation potentially payable to the oversight group under all possible scenarios, including death/disability, retirement, voluntary termination, termination with and without cause and changes of control. The committee should also ensure that the structure of pay at different levels (CEO and others in the oversight group, other executives and non-executive employees) is fair and appropriate in the context of broader company policies and goals and fully justified and explained.

5.3f **Committee Accountability:** In addition to attending all annual and special shareowner meetings, committee members should be available to respond directly to questions about executive compensation; the chair of the committee should take the lead. In addition, the committee should regularly report on its activities to the independent directors of the board, who should review and ratify committee decisions. Committee members should take an active role in preparing the compensation committee report contained in the annual proxy materials, and be responsible for the contents of that report.

5.3g **Outside Advice:** The compensation committee should retain and fire outside experts, including consultants, legal advisers and any other advisers when it deems appropriate, including when negotiating contracts with executives. Individual compensation advisers and their firms should be independent of the client company, its executives and directors and should report solely to the compensation committee. The compensation committee should develop and disclose a formal policy on compensation adviser independence. In addition, the committee should annually disclose an assessment of its advisers' independence, along with a description of the nature and dollar amounts of services commissioned from the advisers and their firms by the client company's management. Companies should not agree to indemnify or limit the liability of compensation advisers or the advisers' firms.

5.3h **Clawbacks:** The compensation committee should develop and disclose a policy for recapturing unearned bonus and incentive payments that were awarded to senior executives due to fraudulent activity, incorrectly stated financial results, or some other cause. At a minimum, the policy should apply to Named Executive Officers, and boards should require repayment in the event of malfeasance involving the executive.

5.3i **Disclosure Practices:** The compensation committee is responsible for ensuring that all aspects of executive compensation are clearly, comprehensively and promptly disclosed, in plain English, in the annual proxy statement regardless of whether such disclosure is required by current rules and regulations. The compensation committee should disclose all information necessary for shareowners to understand how and how much executives are paid and how such pay fits within the overall pay structure of the company. It should provide annual proxy statement disclosure of the committee's compensation decisions with respect to salary, short-term incentive compensation, long-term incentive compensation and all other aspects of executive compensation, including the relative weights assigned to each component of total compensation. Other recommended disclosures relevant to specific elements of executive compensation are detailed below.

5.3j **Benchmarking:** Benchmarking at median or higher levels is a primary contributor to escalating executive compensation. Although benchmarking can be a constructive tool for formulating executive compensation packages, it should not be relied on exclusively. If benchmarking is used, compensation committees should commit to annual disclosure of the companies in peer groups used for benchmarking and/or other comparisons. If the peer group used for compensation purposes is different from that used to compare overall performance, such as the five-year stock return graph required in the annual proxy materials, the compensation committee should describe the differences between the groups and the rationale for choosing between them. In addition to disclosing names of companies used for benchmarking and comparisons, the compensation committee should disclose targets for each compensation element relative to the peer/benchmarking group and year-to-year changes in companies composing peer/benchmark groups.

5.4 Salary

5.4a **Salary Level:** Since salary is one of the few components of executive compensation that is not "at risk," it should be set at a level that yields the highest value for the company at least cost. In general, salary should be set to reflect responsibilities, tenure and past performance, and to be tax efficient—meaning no more than $1 million.

5.4b **Above-median Salary:** The compensation committee should publicly disclose its rationale for paying salaries above the median of the peer group.

5.5 **Annual Incentive Compensation:** Cash incentive compensation plans should be structured to appropriately align executive interests with company goals and objectives and to reasonably reward superior performance that meets or exceeds well-defined and clearly disclosed performance targets that reinforce long-term strategic goals set and approved by the board and written down in advance of the performance cycle.

5.5a **Formula Plans:** The compensation committee should approve formulaic bonus plans containing specific qualitative and quantitative performance-based operational measures designed to reward executives for superior performance related to operational/strategic/other goals set by the board. Such awards should be capped at a reasonable maximum level. These caps should not be calculated as percentages of accounting or other financial measures (such as revenue, operating income or net profit), since these figures may change dramatically due to mergers, acquisitions and other non-performance-related strategic or accounting decisions.

5.5b **Targets:** When setting performance goals for "target" bonuses, the compensation committee should set performance levels below which no bonuses would be paid and above which bonuses would be capped.

5.5c **Changing Targets:** Except in unusual and extraordinary situations, the compensation committee should not "lower the bar" by changing performance targets in the middle of bonus cycles. If performance targets must be lowered, amended or changed in the middle of a performance cycle, reasons for the change and details of the initial targets and adjusted targets should be disclosed.

5.5d **Transparency:** The compensation committee should commit to provide full descriptions of the qualitative and quantitative performance measures and benchmarks used to determine annual incentive compensation, including the weightings of each measure. At the beginning of a period, the compensation committee should calculate and disclose the maximum compensation payable if all performance-related targets are met. At the end of the performance cycle, the compensation committee should disclose actual targets and details on the determination of final payouts.

5.5e **Shareowner Approval:** Shareowners should approve the establishment of, any material amendments to, annual incentive compensation plans covering the oversight group.

5.6 **Long-term Incentive Compensation:** Well-designed compensation programs can lead to superior performance. Long-term incentive compensation, generally in the form of equity-based awards, can be structured to achieve a variety of long-term objectives, including retaining executives, aligning executives' financial interests with the interests of shareowners, and rewarding the achievement of long-term specified strategic goals of the company and/or the superior performance of company stock.

But long-term incentive compensation comes at a cost, and poorly structured awards permit excessive or abusive pay that is detrimental to the company and to shareowners. To maximize effectiveness and efficiency, compensation committees should carefully evaluate the costs and benefits of long-term incentive compensation, ensure that long-term compensation is appropriately structured and consider whether performance and incentive objectives would be enhanced if awards were distributed throughout the company, not simply to top executives.

Companies may rely on a myriad of long-term incentive vehicles—including, but not limited to, performance-based restricted stock/units, phantom shares, stock units and stock options—to achieve a variety of long-term objectives. While the technical underpinnings of long-term incentive awards may differ, the Council believes that the following principles and practices apply to all long-term incentive compensation

awards. And, as detailed below, certain policies are relevant to specific types of long-term incentive awards.

5.6a **Size of Awards:** Compensation committees should set appropriate limits on the size of long-term incentive awards granted to executives. So-called "mega-awards" or outsized awards should be avoided except in extraordinary circumstances, because they may result in rewards that are disproportionate to performance.

5.6b **Vesting Requirements:** Meaningful performance periods and/or cliff vesting requirements—consistent with a company's investment horizon, but no less than three years—should attach to all long-term incentive awards, followed by pro rata vesting over at least two subsequent years for senior executives.

5.6c **Grant Timing:** Except in extraordinary circumstances, such as a permanent change in performance cycles, long-term incentive awards should be granted at the same time each year. Companies should not coordinate stock award grants with the release of material non-public information. The grants should occur whether recently publicized information is positive or negative, and stock options should never be backdated.

5.6d **Hedging:** Compensation committees should prohibit executives and directors from hedging (by buying puts and selling calls or employing other risk-minimizing techniques) equity-based awards granted as long-term incentive compensation or other stock holdings in the company. And, they should strongly discourage other employees from hedging their holdings in company stock.

5.6e **Philosophy/Strategy:** Compensation committees should have a well-articulated philosophy and strategy for long-term incentive compensation, which should be fully and clearly disclosed in the annual proxy statement.

5.6f **Award Specifics:** Compensation committees should disclose the size, distribution, vesting requirements, other performance criteria and grant timing of each type of long-term incentive award granted to the executive oversight group and how each component contributes to long-term performance objectives of a company.

5.6g **Ownership Targets:** Compensation committees should disclose whether and how long-term incentive compensation may be used to satisfy meaningful stock ownership requirements. Disclosure should include whether compensation committees impose post-exercise holding periods or other requirements to ensure that long-term incentive compensation is appropriately used to meet ownership targets.

5.6h **Shareowner Approval:** Shareowners should approve all long-term incentive plans, including equity-based plans, any material amendments to existing plans or any amendments of outstanding awards to shorten vesting requirements, reduce performance targets or otherwise change outstanding long-term incentive awards to benefit executives. Plans should have expiration dates and not be structured as "evergreen," rolling plans.

5.7 **Dilution:** Dilution measures how much the additional issuance of stock may reduce existing shareowners' stake in a company. Dilution is particularly relevant for long-term

incentive compensation plans since these programs essentially issue stock at below-market prices to the recipients. The potential dilution represented by long-term incentive compensation plans is a direct cost to shareowners.

Dilution from long-term incentive compensation plans may be evaluated using a variety of techniques including, but not limited to, the reduction in earnings per share and voting power resulting from the increase in outstanding shares.

5.7a **Philosophy/Strategy:** Compensation committees should develop and disclose the philosophy regarding dilution including definition(s) of dilution, peer group comparisons and specific targets for annual awards and total potential dilution represented by equity compensation programs for the current year and expected for the subsequent four years.

5.7b **Stock Repurchase Programs:** Stock buyback decisions are a capital allocation decision and should not be driven solely for the purpose of minimizing dilution from equity-based compensation plans. The compensation committee should provide information about stock repurchase programs and the extent to which such programs are used to minimize the dilution of equity-based compensation plans.

5.7c **Tabular Disclosure:** The annual proxy statement should include a table detailing the overhang represented by unexercised options and shares available for award and a discussion of the impact of the awards on earnings per share.

5.8 **Stock Option Awards:** Stock options give holders the right, but not the obligation, to buy stock in the future. Options may be structured in a variety of ways. The Council considers some structures and policies preferable because they more effectively ensure that executives are compensated for superior performance. Other structures and policies are inappropriate and should be prohibited.

5.8a **Performance Options:** Stock option prices should be indexed to peer groups, performance-vesting and/or premium-priced to reward superior performance based on the attainment of challenging quantitative goals.

5.8b **Dividend Equivalents:** To ensure that executives are neutral between dividends and stock price appreciation, dividend equivalents should be granted with stock options, but distributed only upon exercise of the option.

5.8c **Stock Option Expensing:** Since stock options have a cost, companies should include these costs as an expense on their reported income statements and disclose valuation assumptions.

5.8d **Discount Options:** No discount options should be awarded.

5.8e **Reload Options:** Reload options should be prohibited.

5.8f **Option Repricing:** "Underwater" options should not be repriced or replaced (either with new options or other equity awards), unless approved by shareowners. Repricing programs, for shareowner approval, should exclude directors and executives, restart vesting periods and mandate value-for-value exchanges in which options are exchanged for a number of equivalently valued options/shares.

5.9 Stock Awards/Units: Stock awards/units and similar equity-based vehicles generally grant holders stock based on the attainment of performance goals and/or tenure requirements. These types of awards are more expensive to the company than options, since holders generally are not required to pay to receive the underlying stock, and therefore should be limited in size.

5.9a Structure: Stock awards should be linked to the attainment of specified performance goals and in some cases to additional time-vesting requirements. Stock awards should not be payable based solely on the attainment of tenure requirements.

5.9b Transparency: The compensation committee should provide full descriptions of the qualitative/quantitative performance measures and benchmarks used and the weightings of each component. Whenever possible, disclosure should include details of performance targets.

5.10 Perquisites: Company perquisites blur the line between personal and business expenses. The Council believes that executives, not companies, should be responsible for paying personal expenses—particularly those that average employees routinely shoulder, such as family and personal travel, financial planning, club memberships and other dues. The compensation committee should ensure that any perquisites are warranted and have a legitimate business purpose, and it should consider capping all perquisites at a de minimis level. Total perquisites should be described, disclosed and valued.

5.11 Employment Contracts, Severance and Change-of-control Payments: Various arrangements may be negotiated to outline terms and conditions for employment and to provide special payments following certain events, such as a termination of employment with/without cause and/or a change in control. The Council believes that these arrangements should be used on a limited basis.

5.11a Employment Contracts: Companies should only provide employment contracts to executives in limited circumstances, such as to provide modest, short-term employment security to a newly hired or recently promoted executive. Such contracts should have a specified termination date (not to exceed three years); contracts should not be “rolling” on an open-ended basis.

5.11b Severance Payments: Executives should be entitled to severance payments in non-control change situations only in the event of wrongful termination, death or disability. Termination for poor performance, resignation under pressure or failure to renew the contract should not qualify as wrongful termination.

5.11c Change-in-control Payments: Any provisions providing for compensation following a change-in-control event should be “double-triggered," stipulating that compensation is payable only: (1) after a control change actually takes place; and (2) if a covered executive's job is terminated because of the control change.

5.11d Gross-ups: Companies should not compensate executives for any excise or additional taxes payable upon the receipt of severance, change-in-control or similar payments.

5.11e **Transparency:** The compensation committee should fully and clearly describe the terms and conditions of employment contracts and any other agreements/arrangements covering the executive oversight group and reasons why the compensation committee believes the agreements are in the best interests of shareowners.

5.11f **Tabular Disclosure:** The compensation committee should provide tabular disclosure of the dollar value payable, including gross-ups and all related taxes payable by the company, to each member of the executive oversight group under each scenario covered by the contracts/agreements/arrangements, including change-in-control, death/disability, termination with/without cause and resignation.

5.11g **Timely Disclosure:** New executive employment contracts or amendments to existing contracts should be immediately disclosed in 8-K filings and promptly disclosed in subsequent 10-Qs.

5.11h **Shareowner Ratification:** Shareowners should ratify all employment contracts, side letters or other agreements providing for severance, change-in-control or other special payments to executives exceeding 2.99 times average annual salary plus annual bonus for the previous three years.

5.12 **Retirement Arrangements:** Deferred compensation plans, supplemental executive retirement plans, retirement packages and other retirement arrangements for highly paid executives can result in hidden and excessive benefits. The Council believes that special retirement arrangements, including ones structured to permit employees whose compensation exceeds IRS limits to fully participate in similar plans covering other employees, should be consistent with programs offered to the general workforce, and they should be reasonable.

5.12a **Supplemental Executive Retirement Plans (SERPs):** Supplemental plans should be an extension of the retirement program covering other employees. They should not include special provisions, such as above-market interest rates and excess service credits, not offered under plans covering other employees. Payments such as stock and stock options, annual/long-term bonuses and other compensation not awarded to other employees and/or not considered in the determination of retirement benefits payable to other employees should not be considered in calculating benefits payable under SERPs.

5.12b **Deferred Compensation Plans:** Investment alternatives offered under deferred compensation plans for executives should mirror those offered to employees in broad-based deferral plans. Above-market returns should not be applied to executive deferrals, and executives should not receive “sweeteners” for deferring cash payments into company stock.

5.12c **Post-retirement Exercise Periods:** Executives should be limited to three-year post-retirement exercise periods for stock option grants.

5.12d **Retirement Benefits:** Executives should not be entitled to special perquisites—such as apartments, automobiles, use of corporate aircraft, security, financial planning—and other benefits upon retirement. Executives are highly compensated employees who should be more than able to cover the costs of their retirements.

5.12e **Transparency:** The terms of any deferred compensation, retirement, SERP or other similar plans covering the executive oversight group should be fully disclosed, in plain English, along with a description of any additional perquisites or benefits payable to executives after retirement.

5.12f **Tabular Disclosure:** A single table should be provided detailing the expected dollar value payable to each member of the executive oversight group under any deferred compensation, retirement, SERP or similar plan, along with a dollar value of any additional perquisites or benefits payable after retirement.

5.13 Stock Ownership

5.13a **Ownership Requirements:** Executives and directors should own, after a reasonable period of time, a meaningful position in the company's common stock. Executives should be required to own stock—excluding unexercised options and unvested stock awards—equal to a multiple of salary, scaled based on position, such as two times salary for lower-level executives and up to six times salary for the CEO.

5.13b **Stock Sales:** Executives should be required to sell stock through pre-announced program sales or by providing a minimum 30-day advance notice of any stock sales.

5.13c **Post-retirement Holdings:** Executives should be required to continue to satisfy the minimum stock holding requirements for at least six months after leaving the company.

5.13d **Transparency:** Companies should disclose stock ownership requirements and whether any members of the executive oversight group are not in compliance.

6. Director Compensation

6.1 Introduction
6.2 Role of the Compensation Committee in Director Compensation
6.3 Retainer
6.4 Equity-based Compensation
6.5 Performance-based Compensation
6.6 Perquisites
6.7 Repricing and Exchange Programs
6.8 Employment Contracts, Severance and Change-of-control Payments
6.9 Retirement Arrangements
6.10 Disgorgement

6.1 **Introduction:** Given the vital importance of the responsibilities assigned to directors, the Council expects that non-employee directors will devote significant time to their boardroom duties.

The Council believes that policy issues related to director compensation are fundamentally different from executive compensation. The Council is supportive of director compensation policies that accomplish the following goals: (1) attract highly qualified candidates; (2) retain highly qualified directors; (3) align directors' interests with those of the long-term owners of the corporation; and (4) provide complete

disclosure to shareowners regarding all components of director compensation including the philosophy behind the program and all forms of compensation.

To accomplish these goals, director compensation should consist solely of a combination of cash retainer and equity-based compensation. The cornerstone of director compensation programs should be alignment of interests through the attainment of significant equity holdings in the company meaningful to each individual director. The Council believes that equity obtained with an individual's own capital provides the best alignment of interests with other shareowners. However, compensation plans can provide supplemental means of obtaining long-term equity holdings through equity compensation, long-term holding requirements and ownership requirements.

The Council believes that companies should have flexibility within certain broad policy parameters to design and implement director compensation plans that suit their unique circumstances. To support this flexibility, investors must have complete and clear disclosure of both the philosophy behind the compensation plan as well as the actual compensation awarded under the plan. Without full disclosure, it is increasingly difficult to earn investors' confidence and support for compensation plans, including both director and executive plans.

Although non-employee director compensation is generally immaterial to a company's bottom line and small relative to executive pay, the Council believes that director compensation is an important piece of a company's governance. Because director pay is set by the board and has inherent conflicts of interest, care must be taken to ensure there is no appearance of impropriety. Companies should pay particular attention to managing these conflicts.

6.2 Role of the Compensation Committee in Director Compensation: The compensation committee (or alternative committee comprised solely of independent directors) is responsible for structuring director pay, subject to approval of all the independent directors, so that it is aligned with the long-term interests of shareowners. The unique fact that directors are setting their own compensation necessitates additional emphasis on the following practices:

6.2a Total Compensation Review: The compensation committee should understand and value each component of director compensation and annually review total compensation potentially payable to each director.

6.2b Outside Advice: The Council believes that committees should have the ability to utilize a compensation consultant for assistance on director compensation plans. In cases where the compensation committee does utilize a consultant, it should always retain an independent compensation consultant or any other advisors as deemed appropriate to assist with the evaluation of the structure and value of director compensation. A summary of the pay consultant's advice should be provided in the annual proxy statement in plain English. The compensation committee should disclose all instances where the consultant is also retained (by the committee) to provide advice on executive compensation. In no circumstances should the committee utilize a consultant for director compensation or executive compensation who is also retained by management.

6.2c Tabular Disclosure: Annual proxy statement disclosure should include a table with columns valuing each component of compensation paid to each director

during the previous year. The table should also include a column estimating the total value, including the present value of equity awards, of each director's annual pay package and any other relevant information. The table should include the number of board meetings and committee meetings attended by the director.

6.2d **Compensation Committee Report:** The annual director compensation disclosure included in the proxy materials should include a discussion of the philosophy for director pay and the processes for setting director pay levels. Reasons for changes in director pay programs should be explained in plain English. Peer group(s) used to compare director pay packages should be fully disclosed, along with differences, if any, from the peer group(s) used for executive pay purposes. While the Council recognizes the value of peer analysis, we do not believe that peer-relative justification should dominate the rationale for (higher) pay levels. Rather, compensation programs should be appropriate for the circumstances of the company. The report should disclose how many committee meetings involved discussions of director pay.

6.3 Retainer

6.3a **Amount of Annual Retainer:** The annual retainer should be the sole form of cash compensation paid to non-employee directors. Ideally, it should reflect an amount appropriate for a director's expected duties, including attending meetings, preparing for meetings/discussions and performing due diligence on sites/operations (which should include routine communications with a broad group of employees.) The Council recognizes that in some combination, the retainer and the equity component combined also reflect the director's contribution from experience and leadership. Retainer amounts may be differentiated to recognize that certain non-employee directors, possibly including independent board chairs, independent lead directors, committee chairs or members of certain committees, are expected to spend more time on board duties than other directors.

6.3b **Meeting Attendance Fees:** The Council opposes meeting attendance fees—whether for board meetings or committee meetings—since meeting attendance is the most basic expectation of a non-employee director.

6.3c **Director Attendance Policy:** The board should have a clearly defined attendance policy. In cases where the committee utilizes any form of financial consequences (loss of a portion of the retainer or equity) as part of the director compensation program, this should be fully disclosed. Financial consequences for poor attendance, while perhaps appropriate in some circumstances, should not be considered in lieu of examining the attendance record, commitment (time spent on director duties) and contribution as integral criterion in director performance and re-nomination decisions.

6.4 **Equity-based Compensation:** The Council believes that equity-based compensation can be an important component of director compensation. These tools are perhaps best suited to accomplish optimal long-term perspective and alignment of interests with shareowners. To accomplish this objective, the Council believes that director compensation should contain an ownership requirement or incentive and minimum holding period requirements.

6.4a **Vesting of Equity-based Awards:** To complement the annual retainer and align director-shareowner interests, non-employee directors shall receive stock awards or stock-related awards such as phantom stock or share units. Equity-based compensation to non-employee directors should be fully vested on the grant date. This point is a marked difference to the Council's policy on executive compensation which calls for performance-based vesting of equity-based awards. While views on this topic have been mixed, the Council believes that the benefits of immediate vesting outweigh the complications. The obvious benefits stem from the immediate alignment of interests with shareowners and the maintenance of independence and objectivity for the director.

6.4b **Ownership Requirements:** The Council suggests ownership requirements of at least three to five times annual compensation. However, the Council is sensitive to situations where qualified director candidates may not have financial means to obtain immediate ownership thresholds. For this reason, companies may adopt unique approaches to providing either a minimum threshold for ownership or incentive to build ownership. This concept should be an integral component of the committee's disclosure related to the philosophy of director pay. It is appropriate to provide a reasonable period of time for directors to meet ownership requirements or guidelines.

6.4c **Holding Periods:** Separate from ownership requirements, the Council believes companies should adopt holding requirements for a significant majority of equity-based grants. These policies should require that directors retain a significant portion (such as 80% for example) of equity grants until after they are retired from the board. These policies should also prohibit the use of any transactions or arrangements that mitigate the risk or benefit of ownership to the director. The Council believes that these transactions and arrangements will inhibit the alignment of interests obtained from providing equity compensation and ownership requirements.

6.4d **Mix of Cash and Equity-based Compensation:** The Council does not advocate a specific split between equity-based and cash compensation. Rather, we believe that companies should have the flexibility to set and adjust this ratio as may be appropriate for the circumstances. Accordingly, the rationale behind this decision is an important element of disclosures related to the overall philosophy of director compensation.

6.4e **Transparency:** The present value of equity awards paid to each director during the previous year and the philosophy and process used in determining director pay should be fully disclosed in the proxy statement.

6.4f **Shareowner Approval:** Current listing standards require shareowner approval of equity-based compensation plans and material amendments to plans (with limited exceptions). The Council strongly supports this concept and advocates that companies adopt conservative interpretations of approval requirements when confronted with choices. (For example, this may include material amendments to the plan).

6.5 **Performance-based Compensation:** While the Council is a strong advocate of performance-based concepts in executive compensation, we do not support performance measures in director compensation. Performance-based compensation

for directors has significant potential to conflict with the director's primary role as an independent representative of shareowners.

6.6 Perquisites: Aside from meeting-related expenses such as air-fare, hotel accommodations and modest travel/accident insurance, the Council believes that directors should receive no other perquisites. Health, life and other forms of insurance, matching grants to charities, financial planning, automobile allowances and other similar perquisites cross the line as benefits offered to employees. The Council believes that charitable awards programs are an unnecessary benefit; directors interested in posthumous donations can do so on their own via estate planning. Infrequent token gifts of modest value are not considered perquisites.

6.7 Repricing and Exchange Programs: The Council believes that under no circumstances should directors participate in or be eligible for repricing or exchange programs.

6.8 Employment Contracts, Severance and Change-of-control Payments: Non-employee directors should not be eligible to receive any change-in-control payments or severance arrangements of any kind.

6.9 Retirement Arrangements

6.9a Retirement Benefits: Since non-employee directors are elected representatives of shareowners and not company employees, they should not be offered retirement benefits such as defined benefit plans or deferred stock awards nor should they be entitled to special post-retirement perquisites.

6.9b Deferred Compensation Plans: The Council does not object to allowing directors to defer cash pay via a deferred compensation plan for directors. However, the Council believes that such investment alternatives offered under deferred compensation plans for directors should mirror those offered to employees in broad-based deferral plans. Non-employee directors should not receive "sweeteners" for deferring cash payments into company stock.

6.10 Disgorgement: Directors should be required to repay compensation to the company in the event of malfeasance or a breach of fiduciary duty involving the director.

7. <u>Independent Director Definition</u>

7.1 Introduction
7.2 Basic Definition of an Independent Director
7.3 Guidelines for Assessing Director Independence

7.1 Introduction: Members of the Council of Institutional Investors believe that the promulgation of a narrowly drawn definition of an independent director (coupled with a policy specifying that at least two-thirds of board members and all members of the audit, compensation and nominating committees should meet this standard) is in the corporation's and all shareowners' ongoing financial interest because:

- Independence is critical to a properly functioning board;
- Certain clearly definable relationships pose a threat to a director's unqualified independence in a sufficient number of cases that they warrant advance identification;

- The effect of a conflict of interest on an individual director is likely to be almost impossible to detect, either by shareowners or other board members; and

- While an across-the-board application of *any* definition to a large number of people will inevitably miscategorize a few of them, this risk is sufficiently small that it is far outweighed by the significant benefits.

The members of the Council recognize that independent directors do not invariably share a single set of qualities that are not shared by non-independent directors. Consequently no clear rule can unerringly describe and distinguish independent directors. However, the independence of the director depends on all relationships the director has, including relationships between directors, that may compromise the director's objectivity and loyalty to shareowners. It is the obligation of the directors to consider all relevant facts and circumstances, to determine whether a director is to be considered independent.

The members of the Council approved the following basic definition of an independent director:

7.2 Basic Definition of an Independent Director: An independent director is someone whose only nontrivial professional, familial or financial connection to the corporation, its chairman, CEO or any other executive officer is his or her directorship. Stated most simply, an independent director is a person whose directorship constitutes his or her only connection to the corporation.

7.3 Guidelines for Assessing Director Independence: The notes that follow are supplied to give added clarity and guidance in interpreting the specified relationships. A director will not be considered independent if he or she:

7.3a Is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, employed by the corporation or employed by or a director of an affiliate;

NOTES: An "affiliate" relationship is established if one entity either alone or pursuant to an arrangement with one or more other persons, owns or has the power to vote more than 20 percent of the equity interest in another, unless some other person, either alone or pursuant to an arrangement with one or more other persons, owns or has the power to vote a greater percentage of the equity interest. For these purposes, joint venture partners and general partners meet the definition of an affiliate, and officers and employees of joint venture enterprises and general partners are considered affiliated. A subsidiary is an affiliate if it is at least 20 percent owned by the corporation.

Affiliates include predecessor companies. A "predecessor" is an entity that within the last 5 years was party to a "merger of equals" with the corporation or represented more than 50 percent of the corporation's sales or assets when such predecessor became part of the corporation.

"Relatives" include spouses, parents, children, step-children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, aunts, uncles, nieces, nephews and first cousins, and anyone sharing the director's home.

7.3b Is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, an employee, director or **greater-than-20-percent** owner of a firm that is one of the corporation's or its affiliate's paid advisers or consultants or that receives revenue of at least $50,000 for being a paid adviser or consultant to an executive officer of the corporation;

NOTES: Advisers or consultants include, but are not limited to, law firms, auditors, accountants, insurance companies and commercial/investment banks. For purposes of this definition, an individual serving "of counsel" to a firm will be considered an employee of that firm.

The term "executive officer" includes the chief executive, operating, financial, legal and accounting officers of a company. This includes the president, treasurer, secretary, controller and any vice-president who is in charge of a principal business unit, division or function (such as sales, administration or finance) or performs a major policymaking function for the corporation.

7.3c Is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, employed by or has had a 5 percent or greater ownership interest in a third-party that provides payments to or receives payments from the corporation **and either: (i) such payments account for 1 percent of the third-party's or 1 percent of the corporation's consolidated gross revenues in any single fiscal year; or (ii) if the third-party is a debtor or creditor of the corporation and the amount owed exceeds 1 percent of the corporation's or third party's assets.** Ownership means beneficial or record ownership, not custodial ownership;

7.3d Has, or in the past 5 years has had, or whose relative has paid or received more than $50,000 in the past 5 years under, a personal contract with the corporation, an executive officer or any affiliate of the corporation;

NOTES: Council members believe that even small personal contracts, no matter how formulated, can threaten a director's complete independence. This includes any arrangement under which the director borrows or lends money to the corporation at rates better (for the director) than those available to normal customers—even if no other services from the director are specified in connection with this relationship;

7.3e Is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, an employee or director of a foundation, university or other non-profit organization that receives significant grants or endowments from the corporation, one of its affiliates or its executive officers or has been a *direct* beneficiary of *any* donations to such an organization;

NOTES: A "significant grant or endowment" is the lesser of $100,000 or 1 percent of total annual donations received by the organization.

7.3f Is, or in the past 5 years has been, or whose relative is, or in the past 5 years has been, part of an interlocking directorate in which the CEO or other employee of the corporation serves on the board of a third-party entity (for-profit or not-for-profit) employing the director **or such relative**;

7.3g Has a relative who is, or in the past 5 years has been, an employee, a director or a 5 percent or greater owner of a third-party entity that is a significant

competitor of the corporation; or

7.3h Is a party to a voting trust, agreement or proxy giving his/her decision making power as a director to management except to the extent there is a fully disclosed and narrow voting arrangement such as those which are customary between venture capitalists and management regarding the venture capitalists' board seats.

The foregoing describes relationships between directors and the corporation. The Council also believes that it is important to discuss relationships between directors on the same board which may threaten either director's independence. A director's objectivity as to the best interests of the shareowners is of utmost importance and connections between directors outside the corporation may threaten such objectivity and promote inappropriate voting blocks. As a result, directors must evaluate all of their relationships with each other to determine whether the director is deemed independent. The board of directors shall investigate and evaluate such relationships using the care, skill, prudence and diligence that a prudent person acting in a like capacity would use.

(updated Sept. 18, 2007)

APPENDIX B

DEFINITION OF INDEPENDENT DIRECTOR

"Independent director" means a director who:

- Is not currently, or within the last five years[34] has not been, employed by the Company in an executive capacity.

- Has not received more than $50,000[35] in direct compensation from the Company during any 12-month period in the last three[36] years other than:

  i. Director and committee fees including bona fide expense reimbursements.
  ii. Payments arising solely from investments in the company's securities.

- Is not affiliated with a company that is an adviser or consultant to the Company or a member of the Company's senior management during any 12-month period in the last three years that has received more than $50,000 from the Company.

- Is not a current employee of a company (customer or supplier) that has made payments to, or received payments from the Company that exceed the greater of $200,000[37] or 2%[38] of such other company's consolidated gross revenues.

- Is not affiliated with a not-for-profit entity (including charitable organizations) that receives contributions from the Company that exceed the greater of $200,000 or 2% of consolidated gross revenues of the recipient for that year.

- Is not part of an interlocking directorate in which the CEO or other employee of the Company serves on the board of another company employing the director.

- Has not had any of the relationships described above with any parent or subsidiary of the Company.

- Is not a member of the immediate family[39] of any person described in Appendix A.

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[34] 5-year look back periods are consistent the Council of Institutional Investors 2006 director independence standards.

[35] $50,000 thresholds are consistent with the Council of Institutional Investors 2006 director independence standards.

[36] 3-year look back periods are consistent with the New York Stock Exchange and NASDAQ 2006 director independence standards.

[37] $200,000 thresholds are consistent with NASDAQ 2006 director independence standards.

[38] 2% thresholds are consistent with New York Stock Exchange director independence standards.

[39] CalPERS defines immediate family consistent with the New York Stock Exchange: spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone who shares such person's home.

APPENDIX C

INDEPENDENT CHAIR/LEAD-DIRECTOR POSITION DUTY STATEMENT

The independent chairperson is responsible for coordinating the activities of the board of directors including, but not limited to, those duties as follows:

- Coordinate the scheduling of board meetings and preparation of agenda material for board meetings and executive sessions of the board's independent or non-management directors.
- Lead board meetings in addition to executive sessions of the board's independent or non-management directors.
- Define the scope, quality, quantity and timeliness of the flow of information between company management and the board that is necessary for the board to effectively and responsibly perform their duties.
- Oversee the process of hiring, firing, evaluating, and compensating the CEO.
- Approve the retention of consultants who report directly to the board.
- Advise the independent board committee chairs in fulfilling their designated roles and responsibilities to the board.
- Interview, along with the chair of the nominating committee, all board candidates, and make recommendations to the nominating committee and the board.
- Assist the board and company officers in assuring compliance with and implementation of the company's Governance Principles.
- Act as principal liaison between the independent directors and the CEO on sensitive issues.
- Coordinate performance evaluations of the CEO, the board, and individual directors.
- Recommend to the full board the membership of the various board committees, as well as selection of the committee chairs.
- Be available for communication with shareowners.

APPENDIX D

Principles for Responsible Investment

Launched in April 2006, The Principles for Responsible Investment (PRI) provides the framework for investors to give appropriate consideration to environment, social and corporate governance (ESG) issues. The PRI was an initiative of the UN Secretary-General and coordinated by UNEP Finance Initiative and the UN Global Compact. An international working group of 20 institutional investors was supported by a 70-person multi-stakeholder group of experts from the investment industry, intergovernmental and governmental organizations, civil society and academia. CalPERS is one of the original signatories.

The Principles

1. We will incorporate ESG issues into investment analysis and decision-making processes.

2. We will be active owners and incorporate ESG issues into our ownership policies and practices.

3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.

4. We will promote acceptance and implementation of the Principles within the investment industry.

5. We will work together to enhance our effectiveness in implementing the Principles.

6. We will each report on our activities and progress towards implementing the Principles.

In signing the Principles, we as investors publicly commit to adopt and implement them, where consistent with our fiduciary responsibilities. We also commit to evaluate the effectiveness and improve the content of the Principles over time. We believe this will improve our ability to meet commitments to beneficiaries as well as better align our investment activities with the broader interests of society.

We encourage other investors to adopt the Principles.

Additional information can be found at www.unpri.org.

APPENDIX E

The Global Sullivan Principles

The Preamble

The Objectives of the Global Sullivan Principles are to support economic, social and political justice by companies where they do business, to support human rights and to encourage equal opportunity at all levels of employment, including racial and gender diversity on decision making committees and Boards; to train and advance disadvantaged workers for technical, supervisory and management opportunities; and to assist with greater tolerance and understanding among peoples, thereby, helping to improve the quality of life for communities, workers and children with dignity and equality.

I urge companies large and small in every part of the world to support and follow the Global Sullivan Principles of corporate social responsibility wherever they have operations.

The Reverend Leon H. Sullivan

The Principles

As a company which endorses the Global Sullivan Principles we will respect the law, and as a responsible member of society we will apply these Principles with integrity consistent with the legitimate role of business. We will develop and implement company policies, procedures, training and internal reporting structures to ensure commitment to these principles throughout our organization. We believe the application of these Principles will achieve greater tolerance and better understanding among peoples, and advance the culture of peace.

Accordingly, we will:

- Express our support for universal human rights and, particularly, those of our employees, the communities within which we operate, and parties with whom we do business.
- Promote equal opportunity for our employees at all levels of the company with respect to issues such as color, race, gender, age, ethnicity or religious beliefs, and operate without unacceptable worker treatment such as the exploitation of children, physical punishment, female abuse, involuntary servitude, or other forms of abuse.
- Respect our employees' voluntary freedom of association.
- Compensate our employees to enable them to meet at least their basic needs and provide the opportunity to improve their skill and capability in order to raise their social and economic opportunities.
- Provide a safe and healthy workplace; protect human health and the environment; and promote sustainable development.
- Promote fair competition including respect for intellectual and other property rights, and not offer, pay or accept bribes.
- Work with governments and communities in which we do business to improve the quality of life in those communities – their educational, cultural, economic and social well-being – and seek to provide training and opportunities for workers from disadvantaged backgrounds.
- Promote the application of these principles by those with whom we do business.

We will be transparent in our implementation of these principles and provide information which demonstrates, publicly, our commitment to them.

APPENDIX F

United Nations Global Compact

The UN Global Compact's ten principles in the areas of human rights, labour, the environment and anti-corruption enjoy universal consensus and are derived from:

The Universal Declaration of Human Rights
The International Labour Organization's Declaration on Fundamental Principles and Rights at Work
The Rio Declaration on Environment and Development
The United Nations Convention Against Corruption
The Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment, and anti-corruption:

Human Rights

Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
Principle 2: make sure that they are not complicit in human rights abuses.

Labour Standards

Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
Principle 4: the elimination of all forms of forced and compulsory labour;
Principle 5: the effective abolition of child labour; and
Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

Principle 7: Businesses should support a precautionary approach to environmental challenges;
Principle 8: undertake initiatives to promote greater environmental responsibility; and
Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

Global Framework for Climate Risk Disclosure

While each sector and company may differ in its approach to disclosure, the most successful corporate climate risk disclosure will be transparent and make clear the key assumptions and methods used to develop it. Companies should directly engage investors and securities analysts in disclosing climate risk through both written documents and discussions.

Investors expect climate risk disclosure to allow them to analyze a company's risks and opportunities and strongly encourage that the disclosure include the following elements:

1. **Emissions – As an important first step in addressing climate risk, companies should disclose their total greenhouse gas emissions. Investors can use this emissions data to help approximate the risk companies may face from future climate change regulations.**

   Specifically, investors strongly encourage companies to disclose:

   - Actual historical direct and indirect emissions since 1990;
   - Current direct and indirect emissions; and
   - Estimated future direct and indirect emissions of greenhouse gases from their operations, purchased electricity, and products/services.[40]

   Investors strongly encourage companies to report absolute emissions using the most widely agreed upon international accounting standard – Corporate Accounting and Reporting Standard (revised edition) of the Greenhouse Gas Protocol, developed by the World Business Council for Sustainable Development and the World Resources Institute.[41] If companies use a different accounting standard, they should specify the standard and the rationale for using it.

2. **Strategic Analysis of Climate Risk and Emissions Management – Investors are looking for analysis that identifies companies' future challenges and opportunities associated with climate change. Investors therefore seek management's strategic analysis of climate risk, including a clear and straightforward statement about implications for competitiveness. Where relevant, the following issues should also be addressed: access to resources, the timeframe that applies to the risk and the firm's plan for meeting any strategic challenges posed by climate risk.**

   Specifically, investors urge companies to disclose a strategic analysis that includes:

   - **Climate Change Statement** – A statement of the company's current position on climate change, its responsibility to address climate change, and its engagement with governments and advocacy organizations to affect climate change policy.
   - **Emissions Management** – Explanation of all significant actions the company is taking to minimize its climate risk and to identify opportunities. Specifically, this should include the actions the company is taking to reduce, offset, or limit greenhouse gas emissions. Actions could include establishment of emissions reduction targets, participation in emissions trading schemes, investment in clean energy

[40] These emissions disclosures correspond with the three "scopes" identified in the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard (revised edition) developed by the World Business Council for Sustainable Development and the World Resources Institute. Scope 1 includes a company's direct greenhouse gas emissions; Scope 2 includes emissions associated with the generation of electricity, heating/cooling, or steam purchased for a company's own consumption; and Scope 3 includes indirect emissions not covered by Scope 2. More information is available at http://www.ghgprotocol.org

[41] Available at http://www.ghgprotocol.org

technologies, and development and design of new products. Descriptions of greenhouse gas reduction activities and mitigation projects should include estimated emission reductions and timelines.

- **Corporate Governance of Climate Change** – A description of the company's corporate governance actions, including whether the Board has been engaged on climate change and the executives in charge of addressing climate risk. In addition, companies should disclose whether executive compensation is tied to meeting corporate climate objectives, and if so, a description of how they are linked.

3. **Assessment of Physical Risks of Climate Change – Climate change is beginning to cause an array of physical effects, many of which can have significant implications for companies and their investors. To help investors analyze these risks, investors encourage companies to analyze and disclose material, physical effects that climate change may have on the company's business and its operations, including their supply chain.**

   Specifically, investors urge companies to begin by disclosing how climate and weather generally affect their business and its operations, including their supply chain. These effects may include the impact of changed weather patterns, such as increased number and intensity of storms; sea-level rise; water availability and other hydrological effects; changes in temperature; and impacts of health effects, such as heat-related illness or disease, on their workforce. After identifying these risk exposures, companies should describe how they could adapt to the physical risks of climate change and estimate the potential costs of adaptation.

4. **Analysis of Regulatory Risks – As governments begin to address climate change by adopting new regulations that limit greenhouse gas emissions, companies with direct or indirect emissions may face regulatory risks that could have significant implications. Investors seek to understand these risks and to assess the potential financial impacts of climate change regulations on the company.**

   Specifically, investors strongly urge companies to disclose:

   - Any known trends, events, demands, commitments, and uncertainties stemming from climate change that are reasonably likely to have a material effect on financial condition or operating performance. This analysis should include consideration of secondary effects of regulation such as increased energy and transportation costs. The analysis should incorporate the possibility that consumer demand may shift sharply due to changes in domestic and international energy markets.

   - A list of all greenhouse gas regulations that have been imposed in the countries in which the company operates and an assessment of the potential financial impact of those rules.

   - The company's expectations concerning the future cost of carbon resulting from emissions reductions of five, ten, and twenty percent below 2000 levels by 2015. Alternatively, companies could analyze and quantify the effect on the firm and shareowner value of a limited number of plausible greenhouse gas regulatory scenarios. These scenarios should include plausible greenhouse gas regulations that are under discussion by governments in countries where they operate. Companies should use the approach that provides the most meaningful disclosure, while also applying, where possible, a common analytic framework in order to facilitate comparative analyses across companies. Companies should clearly state the methods and assumptions used in their analyses for either alternative.

Ceres 14-Point Climate Change Governance Checklist

Board Oversight

1. **Board is actively engaged in climate change policy and has assigned oversight responsibility to board member, board committee or full board.**

Management Execution

2. **Chairman/CEO assumes leadership role in articulating and executing climate change policy.**
3. **Top executives and/or executive committees assigned to manage climate change response strategies.**
4. **Climate change initiatives are integrated into risk management and mainstream business activities.**
5. **Executive officers' compensation is linked to attainment of environmental goals and GHG targets.**

Public Disclosure

6. **Securities filings disclose material risks and opportunities posed by climate change.**
7. **Public communications offer comprehensive, transparent presentation of response measures.**

Emissions Accounting

8. **Company calculates and registers GHG emissions savings and offsets from operations.**
9. **Company conducts annual inventory of GHG emissions and publicly reports results.**
10. **Company has an emissions baseline by which to gauge future GHG emissions trends.**
11. **Company has third-party verification process for GHG emissions data.**

Strategic Planning

12. **Company sets absolute GHG emission reduction targets for facilities, energy use, business travel and other operations (including direct emissions.)**
13. **Company participates in GHG emissions trading programs – up to 30.**
14. **Company pursues business strategies to reduce GHG emissions, minimize exposure to regulatory and physical risks, and maximize opportunities from changing market forces and emerging contols.**

ICGN Remuneration Guidelines
Approved July 7, 2006

Executive Summary

Institutional investors have both a fiduciary responsibility and an economic interest in ensuring that executive remuneration or compensation is well aligned with their interests. The ICGN maintains current and relevant guidelines regarding the process of awarding remuneration and key plan design features to help communicate investors' perspectives on this critical issue. These guidelines update existing ICGN policy and provide further detail in line with recent events[42].

Three principles underpin these updated guidelines: *transparency*, so investors can clearly understand the program and see total pay; *accountability*, to ensure boards maintain the proper alignment in representing owners in part by obtaining shareowner approval of a remuneration report; and *performance-based*, so the programs are linked to relevant measures of company performance over an appropriate timescale. This should also reflect due regard for the reputational aspects of remuneration.

The ICGN believes boards and their mechanisms for deciding upon executive pay play a critical role in representing owners in the process of remuneration design and oversight. It is therefore critical that they adhere to best practices in regard to their process, and that they ensure the relevance, independence, and pertinence of all supporting advisors and material used in setting remuneration programs.

The board is responsible for providing full and complete disclosure of the company's program, with particular emphasis on providing the rationale behind the plan design and how the components of the plan are integrated into an overall remuneration philosophy. The ICGN believes companies should provide a full explanation of the relationship of the plan to performance measures, and should include specific performance targets or hurdles. Boards will adopt different decision making processes for agreeing executive remuneration, be this through remuneration committees, the supervisory board, or sub-groups. The key point is that the mechanism is fully accountable to the governing body and its operation is, and is seen to be, independent and fair.

The ICGN believes plan design should carefully consider the major elements of compensation (cash and short-term incentives, equity and long-term incentives, and post-employment and other benefits), and carefully construct the program to fit the individual circumstances of each company. Accordingly, the ICGN believes the influence of benchmarking or peer relative analysis in establishing compensation levels should be kept to a minimum. The ICGN believes employment contracts, severance, and change in control agreements should be strictly limited, and any use of these tools should be justified within the context of the remuneration philosophy and overall plan design.

Remuneration has an important role in a company's ability to recruit and retain the executive talent it needs to ensure success. It also has the potential to damage reputation, affect employee morale and affect behavior. Getting the balance on time scale and appropriate performance measures is critical. These updated guidelines on remuneration are intended to provide a global benchmark to help shareholders and boards achieve this balance.

Introduction and Purpose

The traditional view of executive remuneration or compensation is to attract and retain qualified personnel. While true in simple terms, this definition fails to consider the significance of compensation programs in the overall governance of organizations. For long-term investors, a much broader view of remuneration is required that encompasses proper alignment, incentives to pursue optimal capital allocation and good corporate governance.

Investors have taken an increased interest and more active role in remuneration in recent years for several reasons. First and foremost, institutional investors have a fiduciary responsibility to act in the best interest of their beneficiaries, and executive remuneration is an important cornerstone.

Secondly, because remuneration programs have such a significant impact on the alignment and incentives of management, they are inexorably linked to the long-term viability of the company. Well designed remuneration

[42] The Caucus Race: Executive Remuneration, 2002.

programs have a demonstrable positive impact on the long-term performance of the company. Conversely, poorly designed or poorly executed compensation plans can have a serious negative impact on shareowner value. In this regard, the opportunity for a significant principal/agent problem arises. Thus, investors have a clear economic interest in addition to a fiduciary interest in the design and implementation of remuneration plans. The combination of these drivers give owners, particularly long-term owners, a role in setting broad policies and guidelines related to executive remuneration and in overseeing the practices of companies in this area through such means as proxy voting and direct engagement.

These guidelines are primarily addressed to companies and their non-executive or supervisory board members, and set out key remuneration principles which should be applied by companies regardless of their domicile. They cannot address every issue related to remuneration. Rather, they reflect the overall policy and philosophical approach to remuneration that leading institutional investors and their associations expect from companies. In this regard, the guidelines set out general principles that reflect best international practice. They should be applied pragmatically, taking into account the specific circumstances of each company and the economic and legal environment in which it operates.

The ICGN believes that best practice in remuneration begins with the formation of an independent and effective process for deciding upon executive remuneration. In many jurisdiction companies have established remuneration committees, comprising independent non-executive or supervisory board members, who can take responsibility for proposing remuneration for approval by the whole board. The purpose of such a committee is to ensure independence and focus in the process. The overall concepts in these guidelines apply regardless of the particular mechanism which is chosen. The important point is that the company establish a formal, independent process for setting remuneration, which is wholly transparent and accountable to shareowners. Any such remuneration committee is considered complementary to the board, and does not remove ultimate responsibility for the full board regarding proper remuneration. For convenience, we term this decision making body a 'remuneration committee', although terms may differ across markets.

The ICGN's guidelines are intended to serve as a communication tool from investors to companies in any domicile and any industry. The ICGN believes remuneration programs should be carefully designed and implemented with the unique situation of each company in mind. However, we believe certain broad principles and guidelines are universal. Within this framework, we recognize the need for flexibility to tailor remuneration programs to meet the challenges and opportunities that each company faces. With this flexibility, it is incumbent upon the company to properly structure a remuneration committee, develop and implement processes for setting remuneration programs, and provide full disclosure of remuneration programs, including all aspects ranging from the philosophy to details of individual executive pay elements.

1.0 Role of the Remuneration Committee

1.1 The remuneration committee is responsible for all aspects of the remuneration program. The committee should take ownership of devising, drafting and implementing the remuneration program.

1.2 The committee should be sufficiently independent in its makeup and process to completely fulfill its role in administering a remuneration program in the best long-term interests of shareowners. Ideally, the committee should comprise entirely independent non-executive directors or supervisory board members. However, depending on best practice in the relevant market, a clear majority of its members should be independent. Special care should be taken to ensure that the committee as a whole has adequate experience and background as well as diverse perspectives. The committee should consist of at least three members. The ICGN is aware that current CEOs of other companies may have a potential conflict or bias in setting their peers' remuneration, yet can also have valuable insights into remuneration issues. The ICGN believes committees should carefully consider the role of other CEOs in the remuneration setting process and should limit the number of CEOs on the committee to ensure independent thinking prevails.

1.3 The committee should have available the necessary resources to fulfill its duties and obligations. This includes controlling all aspects of the engagement of specialist remuneration consultants, including their selection, engagement, and release. Special care should be taken to avoid conflicts of interest that would impair the independence of the consultants. For example, the committee's consultant would not be considered independent if they are also currently engaged by the company's management.

1.4 The committee has the responsibility to integrate all components of remuneration into a cohesive program that supports and is tied to the objectives of the company, which may be both short-term and long-term in nature. Performance measures should include appropriate financial targets, but non-financial targets may also be highly relevant to long term sustainable commercial success.

1.5 In establishing the remuneration program and evaluating appropriate forms as well as levels of remuneration, the committee should take into account all relevant information. This may include the use of peer relative analysis and benchmarking to peer and market examples. However, care should be taken not to over emphasize the influence of peer group benchmarking on the ultimate design of the program. Peer group averages alone are not adequate justification for the design of a remuneration program or the levels of pay. Rather, each company's remuneration program should be carefully designed to fit its unique situation.

1.6 It is the committee's responsibility to maintain appropriate communication with shareholders, either directly or via the board. This includes a responsibility to provide full disclosure regarding the remuneration program, as well as maintain a dialogue and seek input from shareowners as appropriate.

2.0 Remuneration Plan Design

2.1 The ICGN believes remuneration plans should be structured with an appropriate balance of short-term and long-term incentives. This ratio may vary based on market conditions and the specific circumstances of the company. It is incumbent upon the committee to carefully evaluate all relevant information in establishing the desired mix of short-term and long-term remuneration elements, and update this evaluation over time to ensure that the plan evolves to meet the company's changing situation.

2.2 The ICGN believes remuneration plans should be strongly linked to the company's performance that reflects and is consistent with value to long-term shareowners. It is acceptable to provide incentives to achieve both long-term and short-term goals; however, the performance drivers should not be duplicative, and a balance needs to be struck with the need to reward success over the long-term.

2.3 The remuneration committee should establish goals for total remuneration, as well as each major sub component of the plan. This should be done in the context of a total compensation analysis, and committees may use tools such as tally sheets to gain a complete perspective of the remuneration program. This will help the committee evaluate the overall mix of remuneration and determine how to integrate the elements. Remuneration levels may take into account relevant benchmarks and market conditions, but these criteria should not be used exclusively to justify levels of remuneration or plan design. Too much reliance on peer relative analysis leads to unjustified escalation in executive pay that gives rise to concern. Each plan should be tailored to the unique circumstances of the company as well as the responsibilities of the position(s) in question and the experience and expertise of the individual.

2.4 Compensation plans generally consist of four primary categories: cash and short-term incentives; equity and long-term incentives; retirement and post employment benefits and "other" compensation, such as perquisites.

2.4.1 *Cash and Short-Term Incentives.*

The cash component and short-term incentives should generally be tied to annual performance measures. Objectives should be set and recorded at the beginning of the performance period. Companies should disclose the circumstances in which short-term performance measures may be adjusted, including the process and timing of disclosure of these actions. The ICGN believes short-term performance measures should not be adjusted after a brief period of the performance horizon has past, such as the first quarter for example, regardless of the circumstances. Companies should avoid performance periods shorter than 1 year (such as quarterly bonus programs).

2.4.2 *Equity and Long-Term Incentive Tools.*

The equity and long-term incentive component should consist of an appropriate mix of equity and equity like tools, which may include options, restricted shares, stock appreciation rights, and

other equity-like incentive structures for example. The ICGN believes companies should provide clear justification for the types of equity tools employed and the relative mix of these tools.

Companies should provide a clear plan (contained within the remuneration report or other disclosures) that details how these tools will be used including the target dilution levels, cumulative dilution to date, and projected run rates over a multi-year period and actual run rates over previous years. This justification should include the methodology by which companies will determine the appropriate dilution and run rate, and evaluate the effectiveness of the plan over time, including its impact on long-term value creation. The equity plan should also include a maximum annual limit on individual participation and the planed distribution of equity tools (In other words, distribution between the executive ranks and employee base including the rough percentage of the overall plan that will go to each group).

Any potential dilution of shareowners should require prior approval through votes to protect pre-emption rights.

The ICGN believes equity ownership guidelines and holding requirements should be an integral component of company's equity plan and overall compensation philosophy. Equity ownership guidelines are generally expressed as a multiple of salary and bonus opportunity, and serve to align the interests of the management team with the long-term owners. Accordingly, the guidelines should require significant ownership levels over an appropriate period of time. Holding requirements generally require that executives shall hold significant portions of equity grants for extended periods, which should include requirements to hold some portion of grants for a fixed period of time after separation (such as retirement or other event in which employment is ceased).

The ICGN believes the following equity plan characteristics are inappropriate: discount options; re-load provisions; gross-up provisions; accelerated vesting upon change in control; and, repricing without shareholder approval. Companies should also provide clear guidance regarding the circumstances under which key plan criteria may be amended, including performance targets, and including notification to shareowners (disclosure).

Equity (and equity-like) remuneration should have vesting terms that are clearly consistent with the company's capital allocation and investment horizon. The ICGN believes that, as a general rule, vesting of long-term incentives should be a minimum of three years.

The ICGN is opposed to share repurchase plans that are strictly designed to offset equity plan dilution. Share repurchase plans should be an integral component of the company's capital allocation decision, not its remuneration program. Share repurchase plans designed to offset equity plan dilution may lead to poor capital allocation decisions or poor timing of repurchase activity.

Equity grants should be scheduled at regular annual intervals. Companies should adopt and disclose a formal pricing methodology for establishing the strike price of grants where applicable. For example, this may entail a policy of establishing the strike price at the average closing price of the company's common shares over the previous 2 to 4 week period. In no circumstances should boards or management be allowed to back date grants to achieve a more favorable strike price (in the case of options).

2.4.3 *Performance-Based Methodologies.*

The ICGN strongly supports the use of performance measures tied to the vesting of equity and equity-like instruments. This may include indexing or premium pricing methodologies[43] and other

[43] Indexing and premium pricing methodologies are forms of performance-based vesting. Indexed stock options have a strike price set relative to a peer group index such that the strike price is adjusted to reflect the performance of the index. Premium priced options have a strike price set at a premium to the current market at the time they are granted.

performance criteria such as key operational metrics. The ICGN does not support time accelerated vesting[44] as a legitimate or desirable performance vesting methodology.

Performance targets associated with equity components should be consistent with long-term sustained superior performance. This means that performance goals should be constructed to measure sustained performance over long periods (including multiple accounting periods). Care should be taken to mitigate potential unintended negative incentives that may be associated with performance measures. For example, poorly constructed performance programs could provide an opportunity to manipulate short-term accounting measures to meet performance goals.

The ICGN believes plans should be designed to minimize or eliminate potential adverse incentives in the following ways (at a minimum): a) Utilize multiple performance metrics with some offsetting drivers that would mitigate the ability to manipulate accounting measures or drive poor business decisions to reach goals (for example, if revenue growth is a desired performance target, it should be accompanied by a profitability or margin measure to ensure that the "incentive" is not to increase revenue at any cost); b) Utilize performance methodologies that encompass multiple periods, such that no opportunity to manipulate one accounting period over another exists (channel stuffing or expense shifting for example); c) Utilize varied performance metrics over time (perhaps with each year's grant) in an effort to evolve the program with the company's situation and provide diversified performance drivers; and d) companies should adopt a "clawback" policy that provides for the recapture of performance related pay in cases of restatement or fraudulent reporting if either resulted in an award of performance-based remuneration.

In change in control or other corporate events the ICGN believes only pro-rata performance criteria that reflect a real measure of underlying achievement should be awarded. The ICGN is opposed to a blanket acceleration of equity instruments based on corporate events. The remaining equity instruments and performance awards should be tied to the long-term success of the new entity, not the execution of the transaction.

The ICGN does not favor "retesting" or granting of additional time to meet performance goals except in very exceptional circumstances. The company should have a clearly articulated policy on how these considerations will be made and how the company will disclose any material changes to terms of the remuneration plan.

2.4.4 *Post Employment and Other Benefits*

Post employment and other benefits include retirement arrangements (both defined benefit and defined contribution plans), health care, and other benefits such as perquisites (both during and after employment). Should companies utilize any of these forms of remuneration, care should be taken to integrate these structures within the overall philosophy and structure of the total plan. Post employment and other benefits can entail significant liability for the company and may represent significant portions of the total value of the remuneration program. As such, the alignment and incentive characteristics of these elements of the remuneration plan can have a material impact on its overall effectiveness. As a general rule, the ICGN believes post employment benefits and perquisites may significantly detract from the performance and alignment qualities of remuneration plans, while arguably having some value to attract and retain key employees. These competing interests must be balanced strictly in the best long-term interests of the shareholders.

As noted under Section 2.1 and 2.2, the company should disclose all material aspects of the remuneration plan, which includes post employment and other benefits. The ICGN believes companies should disclose the existence of all retirement programs for executives, clearly noting any supplemental benefits or sweeteners provided (such as above market earnings on account balances or additional years of service credit for example). Disclosures related to defined benefit programs should include an estimate of the actuarial present value accrued during the applicable

[44] Time accelerate vesting is a methodology that accelerates the vesting of an equity award based upon meeting some pre-determined criteria or performance hurdle. Under time accelerated vesting, the equity awards will vest eventually vest even if the performance criteria for acceleration are not met, the performance criteria is tied only to the acceleration of vesting.

year, and an estimate of the expected benefit at normal retirement age. These disclosures should be specific to each individual executive covered in the disclosures.

If any portion of post employment benefits (retirement, health, perquisites) is unfunded, the company should provide adequate detail as to the potential liability to the company under these programs.

3.0 Employment Contracts, Severance, and Change in Control Agreements

3.1 The ICGN believes contracts, employment agreements, severance, and change in control arrangements should be strictly limited. As a rule, these arrangements should not adversely affect the executive's alignment of interest with shareowners or their incentive to pursue superior long-term value.

3.2 Employment contracts should not extend longer than 1 to 3 year periods, and should not be open-ended or renewed on an "automatic" basis. Contracts that run for a multi-year period for the purpose of recruitment should revert to a 1 year contract after the initial contract period. Within this, boards should pursue a policy of mitigation to minimize post-employment expenses to executives.

3.3 Employment arrangements should not provide guaranteed raises, bonuses, or other incentives such as equity grants. Such provisions have a negative impact on the alignment and incentive characteristics of the remuneration program.

3.4 Severance payments should be limited to situations of wrongful termination, death, or disability.

3.5 The ICGN believes companies should not utilize change in control agreements or make special arrangements in the event of an equivalent corporate event. Change in control agreements can have a significant detrimental impact on the alignment and incentives of the management team. These arrangements typically tie significant remuneration to the transaction in the form of cash payouts, accelerated vesting of equity, and other benefits that are not well aligned with the long-term interests of the owners or with the success of the new entity.

3.6 Companies should not compensate executives for any excise or additional taxes payable as a result of any employment, severance, or other agreement.

3.7 Companies should provide full disclosure of the existence of all employment agreements, severance arrangements, change in control agreements, or any other contractual agreements with key executives. Disclosure should include a description of the agreements with sufficient detail of all material factors such that shareowners have a complete understanding of their terms. Companies should provide estimated payments under specific scenarios such that shareowners can determine the potential payouts under each agreement.

4.0 Disclosure

4.1 The committee is responsible for providing full disclosure to shareowners and the market of all aspects of the committee's structure, decision making process, and the remuneration program.

4.2 The committee should provide disclosure on at least an annual basis that provides a detailed explanation of the remuneration program. This report should include the company's rationale for the program, including the company's overall remuneration philosophy and how the program is designed to support the company's business objectives. The report should also provide detailed disclosures of the remuneration of each key executive.

Each component of the remuneration program should be identified and its role in the overall compensation program should be justified and explained. This disclosure should include the relative mix of compensation (cash, equity, retirement benefits, perquisites, and other forms of reward) as well as an explanation of how each fits into the performance objectives of the plan. The disclosures should also provide detail on any tax related payments, and favorable treatment provided to executives (such as low rate loans, forgivable loans, or preferential earnings rates).

The report should be detailed enough to allow shareholders to evaluate the minimum and maximum value of remuneration packages in total under different performance scenarios. This should include disclosure of the potential maximum and expected value of performance related remuneration components, and an explanation of the methodology for estimating the expected value.

If the company utilizes any form of employment agreements, change in control agreements, or other contractual arrangements, these should be fully disclosed. The disclosures should include the key terms of these arrangements and the rationale for their use. Care should be taken to articulate how these arrangements are in the best interest of the owners and tied to the long-term performance of the company, if at all.

4.3 Special care should be taken in the remuneration report to provide a full explanation of the relationship of the plan to performance measures. It is the committee's responsibility to integrate all the components of the plan and ensure that the plan as a whole is sufficiently tied to long-term sustained superior performance. The remuneration report should include evidence of the committee's actions in this regard. Any benchmarks or other hurdles contained in the plan or utilized to establish plan design should be disclosed. As a general rule, the ICGN believes companies should disclose performance targets and hurdles at the time they are established, such as when annual cash incentive plans are implemented or when equity grants are made.

4.4 In cases where disclosure of performance hurdles at grant date would divulge commercially competitive information, the company should provide full disclosure of the targets upon measurement or realization of the performance period instead of at grant date.

4.5 The company should obtain shareowner approval of the remuneration report, a remuneration policy, or similar comprehensive disclosure as may be appropriate in the applicable jurisdiction. The purpose of obtaining shareholder approval is to provide owners with an opportunity to formally express their opinion regarding the performance of the company in regards to designing and implementing a remuneration program that is in shareowners' interests. In some cases, approval of a remuneration report is required by regulation or advised by market codes of best practice.

4.6 Disclosures should be presented in a single location and in a clear and understandable format. To the degree possible, tabular disclosures supported by narrative descriptions should be used to organize information.

4.7 The committee or if appropriate in the relevant market, the board, should seek and maintain a constructive dialogue with shareholders and should seek input regarding key elements of remuneration philosophy or plan design.

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APPENDIX J

Joint Venture Governance Guidelines

Businesses used to grow in one of two ways: from grassroots up or by acquisition. In both cases, the manager had control. ***Today businesses grow through alliances, all kinds of dangerous liaisons and joint ventures, which, by the way, very few people understand.***
– Peter Drucker[45]

Good governance matters to joint ventures – and joint ventures matter to many public companies and, therefore, their public shareowners.

Today there are more that 1000 joint ventures (JVs) with more than $1 billion in annual revenues or invested capital. The 8 largest publicly listed oil and gas companies and 6 metals and mining majors have more than $500 billion in assets in major joint ventures. More broadly, many public companies hold a dozen or more material JVs in their portfolios, and depend on JVs for 10-20 percent of total corporate revenues, assets, or income, using joint ventures as a key tool to access technology and innovation, gain scale and reduce costs, share risk, and build new businesses. In such industries as conventional petroleum, alternative energy, chemicals, basic materials, and aerospace, joint ventures account for upwards of 30-50 percent of many company's economic activity. Likewise, joint ventures are widely used in China, India, Russia, Korea, Latin America, and the Middle East.

More than 10 years ago, CalPERS established a set of governance principles for public companies at the corporate level with the underlying tenet that fully accountable corporate governance structures produce, over the long term, the best returns to shareowners.

We believe a similar level of scrutiny and focus should be extended to the largest joint ventures of public companies, and that shareowners will benefit by the application of more consistent standards of governance. These JV Governance Guidelines, co-authored by CalPERS and Water Street Partners[46], are an effort to promote such attention and, in time, drive improved performance and reduced risk within a large but relatively less-transparent asset class.

INTRODUCTION: THE JV GOVERNANCE CHALLENGE

Any joint venture warrants good governance.[47] Our focus – and that of these Guidelines – is on joint ventures that are financially large or strategically significant, and entail some degree of joint managerial decision-making and operational interdependence between the shareowners and the venture.[48]

The governance of these joint ventures introduces unique challenges. These challenges are an outgrowth of the way the corporate-parent shareholders inter-relate to the venture, most notably: shared oversight and control; significant economic and business flows between the shareholders and JV for various services, inputs or outputs; differing appetites for growth, investment, and cash returns from the shareholders (i.e., corporate parents); and changes in shareholder strategies and reactions to new market conditions that put pressure on the JV.

[45] The Post-Capitalist Executive: An Interview with Peter F. Drucker; Harvard Business Review; May-June 1993.
[46] Water Street Partners is an advisory firm based in Washington DC founded by David Ernst and James Bamford, widely-published experts on joint venture strategy and governance who founded and led the Alliance Practice at McKinsey & Company from 1990 to 2008.
[47] We define "joint venture" as a legal business entity owned by two or more separate corporate parents.
[48] To be clear, these guidelines are not aimed at certain types of joint ventures that do not demonstrate these characteristics – notably (1) joint ventures that are purely financial vehicles, such as are common in the real estate and other investment industries, or (2) joint ventures that are clearly operated by one partner and do not function as discreet organizational entities with a management team, board and assets, etc., such has been a hallmark structure of the classic upstream oil and gas joint venture.

To understand why joint ventures are different, consider how the governance of joint ventures *compare to that of public companies*:

Board composition and decision making:

- Public Company Governance: Nonexecutive/independent Board members constitute a majority of the Board, and the Board is an agent for independent shareowners, who are aligned around the basic desire to maximize overall shareowner returns

- JV Governance: In JVs, there are typically no independent Board members from outside the JV and the parent companies; Board members represent parent companies which often have differing objectives, investment and risk preferences, and receive asymmetric benefits from the venture

Resource flows from the shareholders:

- Public Company Governance: The company does not depend on shareowners for operational inputs into the business -- or, if the company does, those transactions are conducted on a true arms-length basis, and subject to legal and governance protections against conflicts of interest

- JV Governance: Commercial relationships are not always easily conducted at arms-length market prices, and conflicts of interest cannot be completely avoided.

Management team:

- Public Company Governance: Members of the management team do not have past or future reporting relationships or employment opportunities with the companies of Board members

- JV Governance: The top JV executives are frequently current or former employees of one shareholder, and their future employment opportunities may be influenced by a parent-company executive who is a Board Director of the JV. In addition, especially for secondees, pension and other compensation elements may be tied to one shareholder *even while serving in the venture*.

While JVs hold some governance advantages to that of public companies,[49] on balance, joint venture governance is *pound for pound* more challenging than corporate governance, and is arguably just as important for public shareowners. CalPERS has long believed that good corporate governance represents "the grain in the balance" that "makes the difference between wallowing for long (and perhaps fatal) periods in the depths of the performance cycle, and responding quickly to correct the corporate course." CalPERS and Water Street Partners believe that, in joint ventures, poor governance represents "an anvil at the end of the table" that can have enormous impact on the stability and performance of these ventures and, by extension, a meaningful impact to their public-company owner(s).

Consider some data. Despite some compelling reasons to enter into joint ventures, the historic performance of JVs has been mixed. Research has shown that roughly 50 percent of JVs fail to meet the financial and strategic goals of the corporate parents, while 46 percent of joint venture announcements have a negative impact on the parent's share price.[50]

Poor governance plays a role in this underperformance – and indeed is preventing many already successful JVs from delivering even better returns to their corporate parents. For instance, an ex post assessment of 49 large joint ventures showed that some 50 percent of failures were the result of poor governance and management.

[49] For example, because JV Board members almost always come from one of the parent companies, tend to be quite experienced in the relevant business area or market; and, as senior managers, are more than willing to assert their views in Board meetings when appropriate to protect shareholder interests. JV Board members also frequently are in a position to do more to help the JV management succeed, e.g. by accessing resources and skills from the parent company.

[50] For more details on joint venture and alliance performance, please see Joel Bleeke and David Ernst, *Collaborating to Compete*, John Wiley & Sons, 1993; David Ernst and Tammy Halevy, "When to Think Alliance," *McKinsey Quarterly*, Q4 2000; James Bamford and David Ernst, "Managing an Alliance Portfolio," *McKinsey Quarterly*, Q3, 2002; and James Bamford and David Ernst, "Getting a Grip on Alliances," *Corporate Dealmaker*, December 2004.

Likewise, some 80 percent of participants of a JV CEO and Directors Roundtable[51] stated that their JV Boards have not been a source of real strength for the JV, and some 60 percent did not have financial management systems in their JVs that were as good as those in their parent businesses.[52] Other research showed a very high correlation between good outcome performance (e.g., financial, operational and strategic results) and good governance performance and health.[53] Similarly, in more than 100 situations involving the restructuring of major joint ventures, the ventures were routinely able to capture 10-30 percent increases in annual profitability by making changes to the governance, scope, and structure of the JV.[54] [55]

Using the petroleum and basic materials industries as proxies, it is possible to estimate the amount of "value restoration" associated with improved JV good governance. For the top 8 petroleum companies and the top 6 basic and mining companies, material joint ventures today account for $72 billion in annual earnings (on a $503 billion asset base). Calculations by Water Street Partners indicate that, conservatively, there is $5-13 billion in improved annual earnings available collectively to these 14 companies. At current trading multiples, this represents roughly $50-130 billion in added market capitalization that could be created through better JV governance and enhanced performance in just these 14 companies. When we extrapolate to other companies in the petroleum and mining industries – and to other industries such as telecom, chemicals, aerospace and defense, industrial manufacturing, and high-tech – there is, at minimum, $15-36 billion in value restoration available from the improved governance and shareholder relationship of material joint ventures.[56]

Despite the importance of JV governance, companies under-invest in governance design. The established body of JV governance case law and accepted good practice are underdeveloped,[57] with little systematic benchmarking of JV governance practices or JV performance. While certain important governance provisions do get included in most JV legal contracts (e.g., Board composition, veto rights, dispute resolution), these provisions address only a narrow set of issues, and tend to focus on establishing a rudimentary framework for governance, plus legal protections against "extreme" events (e.g., material breach, parent bankruptcy). The key legal documents of most major JVs do not come close to meeting the real needs of (i) putting in place an effective ongoing JV governance system; (ii) ensuring that each JV is appropriately monitored by the parent companies; and (iii) triggering interventions on a timely basis, based on appropriate transparency, accountability, and engaged Board members.

We believe that it is useful for corporate and JV Boards to adopt a set of JV governance guidelines – that is, a set of standards or "minimums" for JV governance – against which companies and their public shareholders can

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[51] JV CEO and Directors Roundtable (sponsored by McKinsey and led by James Bamford and David Ernst) in New York on October 13, 2004 (participants ran or oversaw more than 100 major JVs across 10 industries).

[52] A McKinsey survey of 34 companies showed that 53 percent of companies do not regularly incorporate joint ventures into their standard corporate planning and review process, and that 44 percent claim that senior parent executives are not sufficiently focused on joint ventures and other major alliances. (McKinsey survey of Conference Board participants in the 2004 Strategic Alliances Conference, April 2004). Anecdotally, numerous cases where companies leave even their largest joint ventures outside the corporate challenge process. For further details, see James Bamford, David Ernst, and David Fubini, "Launching a Worldclass Joint Venture," *Harvard Business Review*, February 2004.

[53] Results from McKinsey Benchmarking of JV governance (2008), authored by James Bamford, David Ernst and Lois D'Costa, and presented to the Association of Strategic Alliance Professionals in February 2008. This research evaluated the performance and rigorously calibrated a broad set of governance and talent practices of 25 major joint ventures in the oil and gas, basic materials, financial services and other industries in the US, Europe, Asia and the Middle East.

[54] For further details on the value associated with restructuring large joint ventures, see David Ernst and James Bamford, "Your Alliances are Too Stable," *Harvard Business Review*, June 2005.

[55] For other significant work on joint ventures, see: Stephen I. Glover and Craig M. Wasserman (editors and co-authors), *Partnerships, Joint Ventures and Strategic Alliances*, Law Journal Press (2007); Kathryn Rudie Harrigan, *Managing for Joint Venture Success*, Lexington Books (1986); Pierre Dussauge and Bernard Garrette, *Cooperative Strategy: Competing Successfully through Strategic Alliances*, John Wiley (1999); Benjamin Gomes-Casseres *The Alliance Revolution*, Harvard University Press (1996); John Child, David Faulkner and Stephen Tallman, Strategies for Cooperation: Managing Alliances, Networks, and Joint Ventures, Oxford University Press (2005).

[56] For details of this analysis, see Water Street Partners website, waterstreetpartners.net.

[57] A few groups in the oil and gas industry have developed guidelines for auditing certain types of JVs. See, for example, *Guidelines for Joint Venture Audit Standards*, Australian Petroleum Production & Exploration Association Limited, February 2000.

assess the governance of their largest JVs. In proposing these guidelines, our hope is to help improve the performance of these ventures that today serve as a vital – but often challenging – engine for corporate growth.

While our focus is on the material joint ventures of public companies, we believe many of these concepts are equally relevant to JVs that have private or government ownership, as well as smaller joint ventures and complex non-equity partnership structures. We encourage companies to have a discussion about where and how to apply these guidelines in their portfolio of equity joint ventures and non-equity partnerships.

DESIGN OBJECTIVES AND PRINCIPLES

The purpose of these guidelines is to improve the performance and reduce the risks associated with material joint ventures, and to do so by putting in place a set of governance practices that:

- Raise the level of performance management discipline and accountability, which has often proven inconsistent in joint ventures
- Improve decision making speed and the ability of joint ventures to respond rapidly to changes in the market
- Increase transparency overall – within the venture and its board structures, within the corporate parents who own these ventures, and ultimately within the public shareowners of these parent companies
- Promote alignment among the parent companies and put in place mechanisms to deal with the inherent tensions and conflicts that arise between joint venture parent companies
- Create a mechanism for JV Boards to assess the health of governance on a regular basis, promoting proactive adjustments to avoid major issues that can build over time
- Provide a set of guidelines that are *complementary* to existing requirements (e.g., financial disclosure, accounting, compliance, legal, etc.) to which joint ventures are already exposed

JV GOVERNANCE GUIDELINES

CalPERS and Water Street Partners recommend that the Boards of material joint ventures adopt the following guidelines, and put into place practices to support them[58]:

A. Board mandate and structure

1. The Joint Venture Board of Directors is the primary means for governing the joint venture, and the JV CEO reports directly and only to the JV Board. Shareholder input to the JV CEO and JV CFO should be channeled through the Board (and not communicated in an uncoordinated manner to JV management).
2. The JV Board has an explicit charter and delegation of authority framework that defines its role in relation to JV Management, JV Board Committees, and the Boards and Management of the Parent Companies. This charter and framework specifically spells out where venture management has the power to act on its own and where the parents (individually or through the JV Board) will have control, influence or close

[58] These guidelines are aimed at financially large or strategically significant joint ventures that entail some degree of joint managerial decision-making and operational interdependence between the shareholders and the venture. As such, they are not aimed at joint ventures that are, for instance, purely financial vehicles, such as are common in the real estate and other investment industries, or joint ventures that are clearly operated by one partner and do not function as a discreet organizational entities with a management team, board and assets, etc.. Likewise, these guidelines relate to the governance of joint ventures – and not to other important aspects of these business structures, including ownership and financial arrangements, legal issues, including dispute resolution and exit provisions, and human resource and staffing policies.

involvement.[59] The framework also identifies decisions that require separate approval by the Parent Company Boards or Parent Company Management – where approval by the JV Board is not sufficient. The scope of the framework should include matters to fiscal authority, operations, personnel decisions, and strategy (such as changes to the venture's product, pricing or market positioning). The Board periodically reassesses this delegation of authority framework, and takes measures to adjust approval levels based on JV performance and business conditions.

3. The JV Board is responsible for performing the roles of a traditional Corporate Board, including: (i) setting strategy and direction; (ii) approving major capital investments; (iii) ensuring strong performance management and managing financial risk; (iv) protecting shareholder and public interests, including legal, safety, ethics and environmental considerations; and (v) overseeing CEO and top-management hiring, evaluation, compensation and succession planning. In addition, the JV Board is responsible for JV-specific roles, including:

    a. Securing needed resources and organizational commitments from the corporate parents, on a timely basis. This includes facilitating staff rotations as needed between the JV and parent companies

    b. Overseeing the negotiation of major commercial agreements between JV and parent, and shielding the JV CEO and management team from negotiating with parent stakeholders on issues where parent interests are misaligned

    c. Periodically assessing the need for major change in the venture strategy, scope, ownership/financial structure and operating model within the strategic confines defined by the parent company – much as a corporation would challenge the strategy, structure, and, if needed, continued corporate ownership of a business unit

4. The Board has established and maintains an active Audit Committee, which meets more than once a year, and is responsible for reporting and oversight of compliance, financial statement integrity, and overall risk management.[60] At least one Board member has significant financial expertise and is the chair of the Audit Committee.

5. The Board has established and maintains an active Compensation Committee[61], which meets regularly and is responsible for: (i) approving the compensation and incentive framework for the venture's top management team, including developing an annual Performance Contract for the JV CEO; (ii) nominating, evaluating, and determining compensation for the CEO; (iii) overseeing succession planning for the JV CEO and other members of venture top management; and (iv) assisting the JV CEO in ensuring access to skills and people, as needed, from the parent companies.

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[59] Areas where the Board could comment on its level of ongoing involvement include: second-level staffing decisions and performance reviews, product pricing decisions, negotiation of commercial and service agreements between the venture and one of the parents, and development of new growth opportunities. This level of clarity will almost certainly go beyond what is written in the joint venture legal agreement, which typically only spell out matters that require super-majority or unanimous approval, or where one shareholder has veto rights (e.g., hiring of a new CEO or CFO, approval of capital investments above $20M, settlements of litigation against the company, dissolution of the business). While there is some early evidence that less operational involvement by the shareholders / Board is linked to stronger outcome performance, the above governance guideline only aims for the Board to clarify its posture toward the venture, rather than recommend what that posture should be.

[60] One US company that is a highly-experienced user of joint ventures has taken this practice one step further: As a way to promote good financial disciplines and controls, it requires its major JVs to comply with Sarbanes Oxley, and for the JV CEO and JV CFO to provide a written "Sarbanes Oxley Attestation" on a quarterly basis to the company. This attestation is not a legally binding document, but is a powerful signifier of shareholder expectations and driver of individual accountability among the JV management team. The approach is notable because it is above what is required from a legal standpoint: Sarbanes Oxley, as a piece of regulation, applies only to publicly-traded US companies, and therefore is not something that joint venture companies must per se comply with.

[61] This committee may operate under different names, such as Human Resource, People or Talent Committee.

6. The JV Board conducts an annual audit of the joint venture's governance performance, which would include compliance with these governance guidelines and a view of the overall health of the governance system[62]. Related to this:

   a. The JV Board has designated at least one Board member (likely a Lead Director, as described in section B.4) to lead such a review and discussion

   b. The review involves a level of rigor and seriousness similar to other major reviews, and includes a set of criteria against which the shareholders agree to evaluate the venture, a summary of performance, and a discussion of opportunities to improve how the shareholders relate to each other and the venture

B. Board composition and individual roles

1. Absent compelling, unusual circumstances, the JV Board should range from 4 to 10 members. If outside that range, the number of members should be justified.

2. The JV Board has established – and at least annually updates – a set of skills it seeks from Director candidates. Minimally, these skills, across the Board, should include general management experience, finance expertise, experience in the JV industry and with the geographic markets in which the JV operates, and prior experience with other JVs. In selecting members of the Board, the parent companies explicitly account for the desired mix of skills and personal dynamics within the Board overall.

3. Each shareholder has appointed to the JV Board *at least one representative* who is a senior executive of the parent company, and who is able to truly represent the interests of the parent company and command internal resources to support the venture. The following test is to be used to determine if such authority level exists: that Board member has the proven authority to: (i) sign-off on the JV's annual budget and operating plan, within limits consistent with the parent company strategy, budget, and operating plan; (ii) approve the JV's material supply or service contracts; and (iii) approve the JV CEO's annual performance contract and, when needed, the selection of a new CEO of the joint venture.

4. Each parent has designated a Lead Director. The Lead Director is a senior executive of the parent company who:

   a. Spends at least 20 days per year in an active non-executive capacity overseeing and supporting the venture[63]

   b. Performs the following roles: (i) coordinates other Directors from his or her parent company – i.e., ensure opinions heard, consistent voice presented to JV and partner; (ii) accesses resources from inside the parent company in support of the JV; (iii) works with the other Lead Director(s) and JV CEO between Board meetings to resolve issues that do not require full Board approval; (iv) shields the JV from excessive parent company information requests and bureaucracy (e.g., duplicative reporting requirements, slow capex approval processes); and (v) supports the parent executive team and parent board in ensuring that the JV is meeting governance, compliance, risk management and transparency requirements; and, ideally, (vi) explains the JV's strategy, performance, risks and prospects at corporate-level reviews in the parent company.

5. Each Lead Director has an element of his or her annual performance review and short-term variable compensation tied to the performance of the joint venture, and his or her performance as the Lead

[62] Assessments of governance health would likely relate to decision making speed and effectiveness, the delivery of resources and people between the shareholders and parents, the level of transparency and rigor in the reporting and challenge processes, and other factors that the Board deems important to a well-working joint venture governance system.

[63] Our research indicates that such 20-days-per-year Director commitment is in the upper quartile of large joint ventures today; however, we do not believe that this represents exceptional or unrealistic commitment. For comparison purposes, in Corporate Boards, directors spend an average of 24 days (190 hours) per year preparing for and attending Company Board and Board Committee meetings. [Source: Jeremy Bacon, Corporate Boards and Corporate Governance, 22-24 (New York, The Conference Board, 1993).

Director. In no circumstances does the JV account for less than 10 percent of his or her total performance review and short-term variable compensation calculation.

6. The JV Board has designated a Chairperson (who may be the Lead Director from one parent company) to be additionally responsible for: (i) managing the overall Board agenda (including syndication prior to Board meetings of key issues and decisions); and (ii) overseeing the quality, quantity and timeliness of the flow of information to the Board from venture management; and, (iii) unless assigned to another Board member or committee, ensuring the integrity of the governance system, including being responsible for an annual assessment and discussion about governance performance, underlying health, and potential changes to the governance, scope or structure venture to improve its performance.

7. No member of the Joint Venture Management Team is a member of the JV Board.[64]

8. The JV Board ensures that it has a strong independent perspective, preferably by the inclusion of an Independent Director, with stature in the industry.[65] An Independent Director would not be expected to hold a swing vote in Board decisions, and may be a non-voting member of the Board. To additionally promote independence, the Board should: (i) endorse the principle that Board members and full-time venture staff (including secondees) are first and foremost to promote the interests of the venture as a whole (rather than the singular interests of one shareholder), and (ii) periodically invite independent outsiders (e.g., industry experts, customers) to Board meetings to share their perspectives and challenge the Board.[66] To function effectively, an Independent Director needs to have a professional stature and personality that allows him or her to raise issues to and influence the shareholders.

C. Board processes and evaluation

1. Working with executives in the parent companies if need be, the JV Board establishes and periodically updates a set of guiding principles defining the parents' shared philosophy toward the venture.[67] These principles include statements regarding the desired level of independence from the parents, whether the venture is to be run as a business or an operating asset,[68] and the evolution path and, if possible, planned end-game of the venture.

2. The Board has established *performance criteria* for itself as a collective body, and periodically reviews its performance against these criteria.

3. The Board has established performance criteria for its individual Board members, including *individual behavioral expectations*. Minimally, these criteria address the level of Board member attendance, preparedness, participation, and candor. To be re-nominated, directors must satisfactorily perform based on the established criteria; re-nomination on any other basis is neither expected nor guaranteed.

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[64] It is expected that the JV CEO, JV CFO, and other members of the JV management team may be present at JV Board meetings, and may make specific presentations to the Board on the business, operational and financial affairs of the joint venture company.

[65] We define an "Independent Director" as a Board Member not currently an employee of any of the parent companies, and who does not receive compensation for goods and services performed, excluding director fees, for any parent. Despite very limited usage in joint ventures today, we believe that Independent Directors have the potential to be an extremely powerful lever to improve governance performance – creating an independent perspective that is often missing from joint ventures.

[66] Another – and more aggressive – approach to fostering independence (and a strong performance culture) within the JV is to bring in an outside investor (e.g., venture capital or private equity firm) as a 5-10 percent owner of the JV.

[67] As an illustration, one joint venture adopted a set of ten guiding principles that included the following statements: "No Slots – best people for available jobs", "JV Board Members must promote the interests of the JV *as a whole* – not merely advance their own parent's interests," and "Equal Communication – information available to one parent is available to all parents."

[68] By "operating asset" we mean an entity whose purpose is to perform specific operating activities at worldclass levels but is not judged based on its ability to grow into new areas or to drive bottom-line profits. This distinction from a "business" is especially important in the energy, basic materials, and semiconductor industries, where we have seen numerous production joint ventures encounter significant inefficiencies because the management team or one shareholder believed that the venture was to operate as a business, while one or more shareholders believed that the venture was a narrow-purpose production asset.

4. Each director has an attendance rate of at least 75 percent at Board meetings and 75 percent of Board Committee meetings of which they are members, and the Board has established a minimum standard to that effect.

D. Management incentives and reporting relationships

1. The JV CEO reports *solely* to the JV Board, which alone reviews his or her performance and determines his or her compensation.[69] [70]

2. The JV Board has collectively endorsed an annual "performance contract" for the JV CEO, which includes a balanced set of key performance indicators.

3. The JV CEO compensation package is structured to *promote the interests of the joint venture as a whole*, and not asymmetrically advance the interests of a subset of parent companies. The details of this compensation package (including determinants and actual payout) are disclosed to all members of the Board even if the JV CEO is a loaned /seconded employee from one parent company.

4. The JV CEO, working in consultation with the Compensation Committee, has the freedom to offset any compensation disadvantages associated with the joint venture structure (e.g., lack of stock options, reduced career headroom relative to larger global companies, added career risk) with other forms of remuneration.[71] [72]

E. Financial and compliance policies

1. The parents have explicitly established – and collectively endorsed and updated – specific financial hurdle rates for additional investments, dividend repatriation policies, and other key financial policies of the joint venture. (Note: Defining these hurdle rates is typically the job of the parent companies, and therefore JV Board members, depending on their role in the parent company, may or may not have the authority to do this on their own.)

2. The Board subjects the JV to a "challenge process" of equal intensity to similar-sized 100%-owned business units in the corporate parents, and does not allow the JV to be subject to a lower performance

[69] One allowable exception to this guideline would be joint ventures that are clearly operated by one partner, depend on that partner to supply significant numbers of loaned employees to perform the work of the joint venture, and are essentially run as business units of that parent company.

[70] This practice, which ~~we~~ WaterStreet Partners strongly endorse, is a matter of some controversy. An argument is sometimes made that when a JV CEO is a seconded – or loaned – employee from one shareholder, that it is impractical to expect that the JV CEO will have no objectives or interests outside the scope of the joint venture, and it is unrealistic to believe that the JV CEO truly reports solely to the JV Board. This argument is based on a view individuals seconded in as JV CEOs tend to be high-potential individuals who have career goals greater than the specific JV they are running, and that acting solely based on the joint venture's interests – rather than protecting their long-term employer's vested interests when in conflict with the joint venture's interests – turn out to be "career-limiting moves." Our view is that while this may be the unfortunate reality in some cases, it should not be an excuse for a poor practice that drives added misalignment into the system and likely leads over the log-run to suboptimal returns for all shareholders as a group

[71] In one financial services industry JV, members of the JV management team (direct reports to the CEO) were paid annual base salaries of 25 percent higher than similar positions inside the parent companies of the venture, and annual bonuses on par with parent company employees. The rationale for higher base and annual bonus pay relative to the owner banks was that the JV employees, who did not have stock options, had significantly lower opportunities for long-term wealth creation. Similarly, in a multi-billion dollar downstream oil industry venture, the JV pegged employee base pay at the 50th industry percentile benchmark, and the performance-based short-term bonus at the 75th industry percentile benchmark as a way to compensate for some inherent long-term incentive disadvantages of its JV structure.

[72] This problem generally does not exist in joint ventures that are either (i) partially floated on public stock exchanges, or (ii) where the JV employees have phantom equity options based on JV performance.

bar.[73] However, the JV is **not** subject to "double jeopardy" – i.e., full and separate reporting to both corporate parents where the JV must comply with different data and format requirements.[74] [75]

3. The joint venture service and supply agreements with the shareholders are disclosed and made available to all JV Board members, are actively monitored and governed, and ideally, unless there are compelling business reasons otherwise, are set up on an arms-length basis with externally-sourceable specifications, with market-based pricing, and with the JV having the option to source externally.

4. In the event that a Parent Company provides significant and strategically sensitive services to the venture (e.g., potential for leakage of intellectual property, or compromise of customer data or relationships), that parent company provides "compliance training" to those individuals within its own organization who are involved in providing those services to the venture. This training includes what information can – and cannot – be shared, how to prioritize work for the venture relative to internal requests, treatment of cost allocations, and reporting of potential incidence, etc. The Parent Company also reinforces these compliance policies through regular communications regarding the importance of complying with these guidelines and variations.

5. The JV Board takes active and regular steps to ensure compliance with all applicable safety, environmental, anti-corruption (e.g., FCPA), and other regulatory and social requirements of responsible corporate citizenship. A recommended medium for disclosing economic, environmental, and social risks and impacts is the Global Reporting Initiative Sustainability Reporting Guidelines. In particular, the joint venture adopts practices to ensure that the JV does not commit or support human rights violations in countries in which the venture operates.

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Today, there are few if any JVs that follow all of the above governance guidelines, and indeed relatively few companies that have adopted *any* explicit governance guidelines for JVs. Nonetheless, we believe that each of these guidelines is relevant to all material joint ventures of public companies, and that each has the potential to improve venture performance and reduce risk. A decade ago, a growing chorus of commentators began to forcefully make the case that good governance was a key contributor to corporate performance. As one wrote:

> *"Darwin learned that in a competitive environment an organism's chance of survival and reproduction is not simply a matter of chance. If one organism has even a tiny edge over the others, the advantage becomes amplified over time. In 'The Origin of the Species,' Darwin noted, `A grain in the balance will determine which individual shall live and which shall die.' **I suggest that an independent, attentive board is the grain in the balance that leads to a corporate advantage.** A performing board is most likely to respond effectively to a world where the pace of change is accelerating. An inert board is more likely to produce leadership that circles the wagons."*[76]

We assert that good governance matters at least as much in joint ventures – and that there is a significant performance opportunity for public companies. The first step toward capturing the performance upside is for corporate and JV Boards to adopt a set of guidelines to serve as a measuring-stick.

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[73] A number of different approaches can be used to ensure that the JV Board has access to the performance and other information that it needs. In one industrial JV, the parent created a small "affiliate analysis unit" of 4-6 finance staff whose sole job was to make sure that the Board members of three major JVs got the data and analysis they needed (beyond what the JV CEO was providing). In another case, a US-Japanese joint venture made a very deliberate decision to staff the JV itself with very strong finance talent *and* build the financial systems within the JV to create these insights.

[74] There are many different ways to do this. For example, in one 70-30 JV, the approach taken to avoid double jeopardy was for the JV to report to the senior parent management team of the 70% owner in a way that was similar to any business unit, with the key difference being that the Board members from the 30% partner participated in these meetings, challenging the JV from its perspective. In a multi-billion dollar oil industry JV with 50-50 ownership, the JV Board established an independent review process, including a separate and very strong finance and audit committee, as well as aggressive use of outside auditors to benchmark venture performance.

[75] This form of double jeopardy occurs when a JV is forced to comply with both / multiple parents' planning and review processes for the operating plan, budget, and/or capex approval. We believe that in well-governed JVs, the JV Board will coordinate and align these information requests from the parents.

[76] Ira M. Millstein, *New York Times*, April 6, 1997.