
May 14, 2018**Item Name:** Process for Reviewing Closed Session and Other Confidential Materials**Program:** Board Governance**Item Type:** Information**Recommendation**

Consider and discuss whether the current process for Board members to review closed session transcripts and other confidential materials should be retained.

Executive Summary

CalPERS makes momentous and far-reaching decisions about how to invest and spend enormous sums of money held in trust for the benefit of CalPERS' members and beneficiaries. To be effective – to make the best investments, negotiate the best health care rates, and get the best results in pending litigation – many of those decisions must be made in closed session. The Legislature has recognized the importance of and need for these closed sessions by providing for them in the Bagley-Keene Act. The premature divulgence of the materials upon which the Board is making these decisions, or of the Board's deliberations and decisions themselves, undermines CalPERS' effectiveness and can cripple the decision-making process, ultimately costing CalPERS' members, beneficiaries and stakeholders real money.

Motivated by these concerns, the Board President instituted a policy requiring Board members to review transcripts of closed session Board and committee meetings and other confidential materials on site at CalPERS headquarters. The CalPERS team concurs with this approach because it helps ensure the confidentiality of the information and minimizes the opportunity for even inadvertent leaks. The question for the Committee is whether to retain this policy given the logistical difficulties it creates for several Board members.

Strategic Plan

This agenda item supports the 2017-2022 Strategic Plan's goal of cultivating a risk-intelligent organization.

Background and Analysis

By virtue of their responsibilities, trustees and directors in any organization have access to large amounts and varying types of non-public information. The unauthorized or premature disclosure of that information can cause an enterprise great financial harm through the loss of proprietary information that has competitive, commercial value. It can also cause financial institutions like CalPERS real market losses by enabling others to "front run" our transactions. Moreover, as one commentator has explained, "maintenance of confidentiality of material board information is also critical to prevent the corrosive effect breaches of board confidentiality will have on a board's deliberative process and the trust and confidence directors have in each other." Nathan, et al.,

“Maintaining Board Confidentiality” (Harvard Law School Forum on Corporate Governance and Financial Regulation, Jan. 23, 2010) (Nathan Paper) (Attachment 1), at 2. See also Katz, et al., “Corporate Governance Update: Boardroom Confidentiality Under Focus” (New York Law Journal, Jan. 23, 2014) (Katz Paper) (Attachment 2), at 5 (“A major breach of confidentiality, or an ongoing flow of sensitive information outside the board, can have a chilling effect on board deliberations, thereby depriving shareholders of the full benefit of the directors’ expertise and judgment. Meetings are likely to become contentious, and the board may become incapable of consensus or timely decision-making.”) In short, the unauthorized disclosure of confidential and/or privileged information may prevent CalPERS from fulfilling its fiduciary duties to its beneficiaries, and potentially subject the institution and its trustees to civil, and even criminal, liability.

Transcripts of the Board’s closed session meetings are among the most sensitive and confidential materials in CalPERS’ possession. California law recognizes this sensitivity by explicitly providing that recordings of closed session meetings are not public records, and thus not disclosable, under the Public Records Act. (Gov. Code 11126.1.) In further recognition of the sensitive nature of these materials, audio recordings (and transcripts) of closed sessions are only subject to disclosure in litigation if a rigid, proscribed disclosure process involving direct judicial oversight is followed. (Gov. Code 11130(c)(2).) Among the issues within the Board’s jurisdiction, perhaps the most impactful decisions are those involving the fund’s investments. California law recognizes this and the sensitive nature of those decisions by giving the Board broad discretion to consider investment decisions in closed session. (Gov. Code 11126(c)(16).) Put succinctly, discussions held in closed session and the ensuing transcripts are not intended for public consumption except in the most extraordinary circumstances.

Two relatively recent incidents exemplify the damage that can be caused by unauthorized disclosures:

The most sensational type of leak happens when a disgruntled or dissatisfied director provides confidential information to the media in order to put pressure on the rest of the board. One recent headline-making situation involved J.C. Penney director, and activist investor, William Ackman. Ackman was a major stockholder of J.C. Penney, owning nearly 18 percent of the company’s shares through his hedge fund Pershing Square Capital Management. In August 2013, Ackman provided to a major news outlet two letters from himself to the J.C. Penney Board. The letters detailed boardroom discussions and expressed frustration with the leadership of the company and the J.C. Penney board, particularly with respect to the ongoing chief executive search process. The public firestorm that ensued benefited no one; the outcome included high-profile criticism of Ackman’s behavior from prominent members of the corporate community, Ackman’s resigning from the J.C. Penney board, Pershing Square’s sale of its holdings in the company, and a dramatic (and ongoing) decline in the value of J.C. Penney stock.

Katz Paper, at 3.

The problem of directors breaching the confidentiality of board deliberations is not new. In January 2006, for instance, CNET published an article revealing Hewlett-Packard’s long-term strategy on the basis of information supplied by an unnamed insider, later identified as then-director George Keyworth. His identity was only uncovered because Hewlett-Packard hired private investigators who

surreptitiously gained access to e-mail inboxes of the company's directors and certain reporters from CNET. A contentious series of disputes occurred between HP's chairman of the board, Patricia Dunn, who wanted Keyworth to resign, and Keyworth. Months later, after the smoke cleared, Keyworth resigned as a director, another director resigned in protest about the way Keyworth was treated and Dunn resigned as chairman but remained as a director. The culture of the HP board needed to be rebuilt.

Nathan Paper, at 5.

To protect against such disclosures, many entities have adopted corporate (or agency) confidentiality policies that are specific to directors or trustees. Nathan Paper, at 6. CalPERS' Board Governance Policy states that "Board members will not reveal confidential matters and will not use confidential information for personal gain or for the benefit of outside interests." Board Governance Policy, Section X.O, at p. 21.¹ In November of 2012 the Board further defined Board members' responsibility with respect to confidential information when it adopted the Board Confidentiality Policy (Attachment 3). In addition to prohibiting Board members from providing confidential information to unauthorized persons, the Policy states that "[t]he Board President may take all actions necessary to ensure that Confidential Information in the possession of Board Members is not improperly disseminated or revealed."

Pursuant to that direction, the Board President has required Board members to review confidential materials on site. Your team agrees with this approach. In fact, under certain circumstances it could be a breach of fiduciary duty for the Board *not* to restrict access to confidential materials. At a minimum, taking significant measures to protect the security of closed session discussions and transcripts is a best practice.

On the other hand, this practice makes it logistically more difficult for Board members who do not reside in Sacramento to discharge their responsibilities, as it requires Board members to review these materials at CalPERS' headquarters in Sacramento. In its discussion of this agenda item, the Committee should weigh the costs to the System of additional leaks against these logistical difficulties.

Budget and Fiscal Impacts

To the extent the President's existing policy requires some Board members to make additional trips to Sacramento to review confidential materials, System costs will increase by the cost of those trips.

Benefits and Risks

Additional and/or continual leaks of confidential corporate information can cause grave harm to CalPERS. Such leaks also risk exposing both the System and individual Board members to serious sanctions and civil liability.

¹ In addition, the Board Statement of Inconsistent Activities states that "[t]he following activities are deemed to be inconsistent, incompatible, in conflict with, or inimical to the duties and obligations of PERS Board Members: . . . [u]sing confidential information available by virtue of holding a position on the PERS Board (including, but not limited to, confidential data filed by a member or beneficiary with the Board, and confidential contract, financial, investment or legal information) for private gain or advantage, or for the private gain or advantage of another . . . [or] to persons to whom issuance of this information has not been authorized."

Attachments

Attachment 1 – Nathan Paper

Attachment 2 – Katz Paper

Attachment 3 – CalPERS Board Confidentiality Policy

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