NATIONAL ASSOCIATION OF CORPORATE DIRECTORS

REPORT OF THE NACD
BLUE RIBBON COMMISSION

The Governance Committee:

Driving Board Performance
Best Practices and Key Resources

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Report of the
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on

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2007

A Publication of the
The National Association of Corporate Directors®

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National Association of Corporate Directors (NACD), an independent not-for-profit organization founded in 1977, is the country's only membership organization devoted exclusively to improving corporate board performance. The NACD conducts educational programs and standard-setting research, and provides information and guidance on a variety of board governance issues and practices. Membership comprises board members from U.S. and overseas companies ranging from large publicly held corporations to small over-the-counter, closely held, and private firms. With chapters in many major cities providing educational programs and networking opportunities, NACD operates at both a national and local level.

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Foreword from the Chair: Governance at a Crossroads

Responsibility for a corporation's governance, long treated as secondary to the more important task of nominating directors, has finally come into its own as an oversight area worthy of standing committee status.

Today governance committees are at the crossroads of a change that can have significant impact on corporate performance and ethics. The challenge for the governance committee is to focus on performance rather than mere compliance.

Transcending conformity with governance rules and regulations, the committee can and should become the board's performance committee, helping directors across their range of responsibilities to contribute value on a continual basis to the board and to the corporation.

Reasons for Greater Prevalence of Governance Committees

Governance committees (in contrast to a narrower "nominating" committee) are still relatively new, but they are far more common today in part because stock exchanges now require them. But aside from these requirements, boards have practical reasons for forming governance committees.

- First, the definition of "governance" has evolved over the years, becoming broader in its meaning to include both internal board operations and external stakeholder relations.
- Second, the relationship between corporate governance (and by association, the governance committee) and corporate performance has become more evident, both on the upside and downside. The presence or absence of good governance practices can contribute to economic strength or weakness. To date, most of the proof has been on the negative side: lack of truly effective governance contributed to the downfall of several major companies at the beginning of this decade. But a growing number of studies—numbering in the hundreds—are exploring the positive economic benefits of effective governance—a topic for future NACD research.[1]
- Third, the definition of "corporate performance" itself is evolving. An increasing number of boards are looking at nonfinancial measures of corporate value, including the value of reputation. Strong governance can be an important component in building that value.
- Also, the increased workload of boards is forcing the delegation of many of their

responsibilities to committees. The governance committee plays a key role in allocating the work of the board to various committees, helping to keep board structure, makeup, and operations finely tuned.

- Finally, shareholders have been asking for a greater voice in director nominations and elections, forcing boards to prove that they are indeed doing a good job in nominating directors—one of the key functions of governance committees.

A Distinguished Commission

Understanding the importance of the governance committee, NACD published a handbook on this subject shortly after the passage of Sarbanes-Oxley. Today, with so many pressures facing the committee, NACD decided to convene a Blue Ribbon Commission (BRC) to maximize the potential of this important committee. This report, like others in the ongoing BRC series, provides up-to-date guidance on best practices in the current environment, and takes stances in some controversial areas.

For this purpose, NACD recruited a group of individuals well qualified to serve on this BRC. Diverse experience yields the deepest wisdom, so we sought individuals who have served on or advised corporate governance committees in a variety of companies and sectors.

Earning the Right to Serve

The era of entitlement is long past. Directors collectively and individually must earn the right to serve. The governance committee, by helping the board deliver maximum value to the corporation, helps directors earn that right.

We hope that you will find this report useful as you structure and improve governance committees and boards that will be valued by all stakeholders, and especially stockholders. As such, we trust that through you, the reader, this report will make a significant contribution to the "crossroads of change" where governance progress makes its home.

John A. Krol, Chair
NACD Blue Ribbon Commission on the Governance Committee

Key Recommendations

The governance committee works closely with the board chair and the full board to move the board and company toward ever-improving performance.

While the Commission recognizes that there is no single right answer as to how governance committees should function, we have developed a set of key recommendations for maximizing the committee's potential:

- ***Every board should create a formal governance committee responsible for overseeing the structure and process of the company's governance.***

- ***The governance committee should be headed by an independent-minded governance committee chair, who has a well-defined role.***

- ***The governance committee should be given clear authority to shape and recommend to the board policy and board structure, and should devote the necessary time and resources to do so.***

- ***The governance committee's search for new director nominees should be ongoing, and based in the current and emerging strategic needs of the company as understood by management together with the board.***

- ***The governance committee should evaluate itself and spearhead the board evaluation process.***

- ***The governance committee should ensure that relevant orientation is provided for new directors, and also ensure that continuing education in governance and in relevant business topics is provided for the entire board.***

Introduction
The Governance Committee Comes of Age

The earliest corporations were structured to enhance and protect the profits of owner-managers; their "governance" and performance were inseparable. It was not until corporate directors and investors emerged as two separate and distinct groups during the last century that shareholders and others started questioning the connection between corporate governance and financial performance.

As corporations needed to attract capital for ever larger endeavors, the distribution of stock to a wider audience resulted in the separation of corporate ownership from control of business operations and decisions. Historians of the "modern corporation" identified this as an agency problem: when the persons owning the corporation were no longer the same as the persons running the company, a governance structure was needed to hold the managers accountable to the owners for corporate "performance."[1]

The "corporate governance movement" of the last twenty years has focused on increasing the independence and attentiveness of directors, improving board oversight of management, and enhancing the participation of shareholders. A specialized committee of the board to focus on governance processes and practices is the natural result of these developments, and when well utilized should help improve board effectiveness in serving as the link between management and shareholders that helps close the governance performance gap.

THE BROADENING SCOPE OF "GOVERNANCE"

Governance committees face an important trend: *a broadening scope and importance of their work.* These committees work in a world where the term "governance" has come to include a broad array of issues both internal (e.g., board size and other policies) and external (e.g., shareholder relations and social responsibility). Many new listing requirements passed in the wake of Sarbanes-Oxley are referred to as "governance" requirements simply because they pertain to the board of directors.

NEW CHALLENGES FOR GOVERNANCE

The changes that have been evolving over the last quarter century have given rise to new challenges for governance committees in three areas: director selection and nominations; director elections; and governance ratings. Shareholder resolutions urging these changes have evolved from being a fringe activity supported by less than 10 percent of all shareholders to a mainstream platform advanced by institutional investors—in some cases garnering more than 50 percent of the vote. [2]

Director Selection and Nominations

Changes may be afoot in director nominations as well. Shareholder groups have long sought access to company proxy cards for the purpose of including their chosen candidates' names, rather than having to expend large amounts of money and energy in mailing their own proxies. In October 2003, the SEC solicited comments on a proposed proxy access rule that was very popular with shareholders. That rule set a 3% threshold of stock ownership to gain access, and was ultimately stalled because of strong opposition from some corporations.

On July 25, 2007, the SEC again voted to seek public comment, this time on *two* proposed rules. One proposed rule is moderately pro-access. It would give qualified shareholders (holding 5% or more for at least one year) the right to propose access resolutions for inclusion in company proxy materials. The SEC has set a higher threshold in this proposed rule, in the hopes of softening business opposition. The higher the threshold, the more likely it will be that only shareholders with a long-term perspective will seek direct access. The other proposed rule would give companies a continued right to *exclude* shareholder access resolutions from company proxy materials under certain conditions. Comments are due by October 2, 2007.

Director Elections

Another trend heightening the importance of governance committee work is the changing nature of director elections. Plurality voting, the default rule under most state corporate laws, allows individuals to win elections even if they do not receive a majority of votes cast. They merely need to receive a stated "plurality" of votes, as the standards may define, which could mean election with just a single affirmative vote. Some shareholders have complained that plurality voting tends to favor the status quo, leaving shareholders without a meaningful voice in the election process.

So-called "majority voting," by contrast, requires directors to receive a majority of votes cast in order to win a seat on the board. Recent amendments to both the Model Business Corporation Act and the Delaware corporate law now allow corporations to adopt the majority standard. (Plurality voting will continue to be used in contested elections.)

In response, some public companies have adopted policies requiring directors to submit a letter of resignation in the event they receive more withhold votes than affirmative votes for their election. A number of public company boards have changed their bylaws to permit majority voting, a change advocated by an increasing number of shareholder activists. According to the February 2007 edition of "Study of Majority Voting in Director Elections [3], over 52% of the companies in the S&P 500 have adopted a majority vote policy, bylaw, and/or charter provision, compared to under 20% of the companies in that index when the study was initially published in February 2006.

In June 2006, the Committee on Corporate

Laws of the Section of Business Law of the American Bar Association (ABA) approved amendments to the Model Business Corporation Act that keep plurality voting as the default standard for elections, but let companies "opt in" to a form of majority voting. In its 2007 publication, *Corporate Director's Guidebook,* the Committee writes, "…it is very likely that over the next few years, majority voting (in its many forms) will become more prevalent among public companies."[4]

Other Issues Pertaining to Director Elections

In other developments, the SEC has been reexamining rules for broker discretionary voting in director elections as well as rules for broker votes on behalf of beneficial owners "objecting" to disclosure of their identity as owners. The SEC held roundtables on these and related subjects in May 2007.[5]

- *Broker discretionary voting for director elections.* Under Rule 452, NYSE members (brokers and banks) can vote shares on behalf of the beneficial owners on routine proposals. In June 2006, a NYSE Working Group—noting that "shareholder voting for directors is a critical component of good corporate governance"—recommended that Rule 452 be amended to ban discretionary broker voting for director elections. The NYSE has proposed such an amendment, except in the case of mutual funds.[6]
- *NOBO-OBO rules.* Current rules permit stockholders who buy stock through a broker to remain anonymous to the companies they buy. An owner can identify himself or herself as an "objecting beneficial owner" (OBO), or "non-objecting beneficial owner" (NOBO). Currently, the default choice is OBO, which shields the purchaser's identity. This makes direct communication with the purchaser more difficult and costly for the company in director elections and other matters.[7] NACD has joined with the Business Roundtable and other groups to remove this impediment to transparent communications between companies and their owners.[8]

Corporate Governance Ratings

In another cross-current of change, several independent organizations issue governance ratings or scores based on a variety of standards, including the policies that the rated companies describe in their corporate governance guidelines. While directors may question the empirical basis for the ratings, the fact remains that stakeholders of all kinds read these rating agencies' standards, becoming one factor in shaping board operations.[9]

The list of organizations involved in rating boards (and in some cases governance committees[10]) includes:

- Glass Lewis
- GovernanceMetrics International
- Proxy Governance
- Risk Metrics Group/Institutional Shareholder Services
- The Corporate Library

The other three dominant national rating agencies: Standard and Poor's, Moody's Investors Service Inc., and Fitch Ratings Ltd., each perform corporate governance assessment as part of their overall rating, but do not offer stand-alone governance rating services.

As noted in the foreword to this report, a growing number of studies are exploring the positive economic benefits of effective governance. For example, some research has shown a positive correlation between high governance ratings and high returns on shareholders' investments.[11] These findings suggest that some governance practices promoted by rating agencies may have a positive impact on firm value over the long term.

Chapter 1
Improving Board Performance

Key recommendation:

- ***Every board should create a formal governance committee responsible for overseeing the structure and process of the company's governance.***[1]

As stated in the Introduction, the governance committee helps the board to improve its performance. This leads to the following recommendation, which should apply broadly to all companies, not just public ones:

- ***Effective governance practices are those that, in addition to conforming to legal or listing requirements, assist the board to provide oversight and support of management's efforts to drive long-term financial performance and foster an ethical tone at the top and throughout the organization. The governance committee is designed to help the board develop and implement effective governance practices.***

The board is at the heart of governance and the governance committee is at the heart of the board. As such, all directors need to know and understand the purpose and responsibilities of the governance committee in order to move the board and the company toward ever-improving performance.

THE GOVERNANCE COMMITTEE'S SIGNIFICANT ROLE

At a minimum, the governance committee today has the following tasks (required of all New York Stock Exchange (NYSE) companies, and recommended for others):

- Identifying individuals who are qualified to become board members consistent with criteria that were approved by the full board
- Selecting (for board approval), or recommending that the board select, the director nominees for the next annual meeting of shareholders
- Developing and recommending to the board a set of corporate governance guidelines and policies for the corporation
- Overseeing the evaluation of the board (including its committees) and management, and an annual performance evaluation of the committee itself.[2]

These duties all focus on board performance: building the board, setting performance standards, and providing performance feedback.

Any of these functions may be assigned to a separate committee as long as that committee is "independent" by NYSE standards.[3] In most cases, however, governance committees perform all these functions—and others—themselves. For example, the listing standards permit boards to have an independent committee for "nominating" and another independent committee for "governance."[4,5] The naming of committees is at the board's discretion, as long as the basic tasks described in the charter get accomplished. (See **Appendix A** for a sample governance committee charter.)

In this report, we use the term "governance committee" to refer generally to any committee with governance responsibilities, including nominating responsibilities. Any references to a committee with "nominating" in the title are specific to the rule or company cited.

THE GOVERNANCE COMMITTEE AS A CATALYST OF IMPROVEMENT

Governance committees today have a broad mandate on behalf of the board: to ensure effective governance at the companies they serve, and to drive continuous improvement in governance practices. Implicit in this goal is the belief that effective governance will deliver what most shareholders want: strong financial performance over the long term.

The Link to Performance

In order to link governance practices to long-term financial performance, boards must look to the future and learn from the past. The board in general and the governance committee in particular must understand what areas the business or organization will be entering into in the future, and what risks the strategy poses. The governance committee needs to make sure that directors' qualifications are suitable to the organization's strategy and risk profile.

The nexus linking governance, performance, and strategy can be seen in the definition of governance advanced by the Organization of Economic Cooperation and Development (OECD):

> Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. *By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.*[6]

The Link to Ethics

Under Section 406 of the Sarbanes-Oxley Act, all public companies, including foreign issuers, must disclose in their annual report whether or not they have adopted a written code of ethics for the chief executive officer, the chief financial officer, the principal accounting officer or controller, and certain others. If they don't have a code, they have to explain why. Company codes

CURRENT SEC RULES AND STOCK EXCHANGE LISTING REQUIREMENTS*

The Securities and Exchange Commission, New York Stock Exchange (NYSE), NASDAQ Stock Market, and American Stock Exchange (Amex) have all approved or proposed rules that affect the work of the governance committee.

SEC Rules

The SEC requires all registered companies to make disclosures about their "nominating"* committees in their proxy statements, including:

- Whether or not it has a nominating committee, and if not, why not.
- The committee's charter, if any.
- The committee's processes for identifying and evaluating candidates (including whether they received a nomination from a holder of 5 percent stock or more, and, if so, how the committee responded).
- The minimum qualifications for a committee-recommended nominee and any qualities and skills that the nominating committee believes are necessary or desirable for board members to possess.
- Whether committee members are "independent" within the requirements of listing standards (NYSE, NASDAQ, and Amex). It also asks companies to explain how their nomination process works.
- Identification of the persons who recommended each nominee, to demonstrate consideration of the candidate from a variety of sources, including shareholders.
- Disclosure of "third parties that receive compensation related to identifying and evaluating candidates."

NYSE Rules

NYSE listing requirements approved by the SEC on November 4, 2003, contain these additional requirements (among others):

- Every listed company must create a "nominating*/corporate governance" committee composed entirely of independent directors.
- Every nominating/governance committee (as well as other key committees) must have a written charter that addresses its core purpose and responsibilities, as outlined previously (on p. X).
- Every company website must post the charters of its key committees (including the "nominating/corporate governance" committee).

NASDAQ Rules

NASDAQ rules[4], also approved by the SEC on November 4, 2003, state that:

- All director nominees must be selected or recommended for the board's selection by a "nominating*" committee that is composed of independent directors, or, if no such committee exists, by a majority of the independent directors.
- Votes for directors (nominees) must occur without management present.

Amex Rules

Amex rules[5] approved by the SEC on December 1, 2003, state that:

- Listed companies may include a non-independent director on a nominating* committee, as long as the board determines that this appointment is in the best interests of the company, and explains its reasons in the proxy statement.
- Listed companies must adopt a written charter for their nominating* committee, or pass a board resolution describing the nominations process and related matters.

*Note that rules may be different for controlled companies.

**Although all of these rules use the term "nominating," the additional term "governance," used by the New York Stock Exchange, is becoming more common.*

can vary, but to meet the SEC requirements developed under Sarbanes-Oxley, Section 406, a company's code of ethics should be reasonably designed to deter wrongdoing and to promote:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. Full, fair, accurate, timely and understandable disclosure in reports and documents that an issuer files with, or submits to, the SEC and in other public communications made by the issuer;
3. Compliance with applicable governmental laws, rules, and regulations;
4. Prompt internal reporting of code violations to "an appropriate person or persons" identified in the code; and
5. Accountability for adherence to the code.[7]

In addition to this description, boards have other sources of guidance in corporate ethics:

- The NYSE and NASDAQ listing requirements require a code of conduct that conforms to the requirements of Section 406, with additional requirements for NYSE companies. Namely, the code must address: conflicts of interest; corporate opportunities; confidentiality; fair dealing with customers, suppliers, competitors, and employees; protection and use of company assets; compliance with laws, rules, and regulations, including insider trading laws; and encouraging the reporting of any illegal or unethical behavior.
- The U.S. Sentencing Guidelines describe seven ethics/compliance program elements that, if present, can help a corporation receive a more lenient sentence following a conviction for criminal wrongdoing: (1) compliance standards and procedures (such as a code of conduct or ethics); (2) oversight by high-level personnel (e.g., a compliance or ethics officer); (3) due care when delegating authority; (4) effective communication of standards and procedures (e.g., training); (5) auditing or monitoring systems and reporting mechanisms (e.g., a "hotline"); (6) enforcement of disciplinary mechanisms; and (7) appropriate response after detection.[8]
- Plaintiffs in *In re Caremark International Inc. Derivative Litigation* alleged that inadequate oversight allowed some company employees to engage in illegal behavior that later became costly to the company. Chancellor William Allen wrote: "A director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists," and that "failure to do so under some circumstances may, in theory at least, render a director liable for losses."[9]

All directors, including governance committee members, would be wise to heed all these sources of guidance, including the last one. Although criminal conviction and sentencing might seem like a distant possibility to law-abiding and ethical directors reading this report, unfortunately white collar crime can strike—or be alleged—anywhere. That is, virtually any company can find itself the victim of "criminal" behavior on the part of employees—including unintentional behavior that has been criminalized (for example, failure to notice a material misstatement in an offering prospectus).

The governance committee should regularly review the company's code of ethics to be sure that it expresses high standards for ethical behavior.

Management is responsible for the code's development and implementation, and the audit committee plays a key role regarding the code (and any waiver thereof with respect to officers and directors), both due to regulations and to its link to the internal control environment. The governance committee can take a central role in what must be a company-wide commitment to an ethical culture by making sure that the code is communicated and respected.

The key factor is the "tone at the top"—the ethics of the CEO and the board, which are also expected of all employees. The effective governance committee will have a good working relationship with the organization's CEO who more than any other single person will set the tone for the company.[10]

LEADERSHIP AND THE GOVERNANCE COMMITTEE

The governance committee does more than "nominate" directors; it helps to determine the structure for board leadership and the process by which leaders will be selected. As boards rise in importance, new leadership paradigms are forming. Some boards divide their chair and CEO positions while others combine them, often appointing an independent lead director to manage the work of the board. It is up to the governance committee to raise, for discussion by the full board, fundamental questions such as:

- Who will lead the board?
- Who will lead each board committee?
- How will these individuals be selected?

Although governance committee chairs often serve in a leadership capacity (as "lead director," board chair, or a successor to the board chair) they must ultimately serve the entire board. The next chapter focuses on this important role and the balance it must strike between governance leadership and service.

Chapter 2
Chairing the Governance Committee

Key recommendation:

The governance committee should be headed by an independent-minded governance committee chair, who has a well-defined role.

The governance committee chair plays an important role in the work of the board. Defining that role requires involvement from the entire board, which should determine its own leadership structure. While it is beyond the scope of this report to articulate the possible permutations of leadership that a board might adopt, a previous Blue Ribbon Commission did just that, in "*Report of the NACD Blue Ribbon Commission on Board Leadership*."[1]

For the purposes of this report, the role of the governance committee chair may, in some cases, be interchangeable with that of the lead director; indeed, on many boards, the governance committee chair functions as the lead director. Boards decide for themselves how to allocate duties if there are both a lead director and a governance committee chair.

The key ingredient for the entire board in structuring its leadership is an understanding of and respect for the CEO, who leads the company, and the board chair, who leads the board; on some boards, they are the same person. The governance committee chair exercises leadership within this larger leadership context. (See the end of this chapter for a brief discussion of the relationship among the roles of CEO, board chair, lead director, and governance committee chair.)

WHO SHOULD CHAIR THE GOVERNANCE COMMITTEE?

Through the work of a dynamic chair, the governance committee can be recognized as a forward-looking policy and performance committee. The chair is directly accountable for ensuring achievement of the committee's work, and sets the tone for that work. Thus a primary step in the formation and operation of any effective governance committee (indeed, any committee) is the choice of its chair. This leader will influence not only the work of the committee, but also the work of the board.

Selecting the right person to fill the position of governance committee chair falls to the full board; however in some cases, the choice of chair may be made by the governance committee itself, subject to ratification by the full board.

Certain traits are particularly desirable in a governance chair, regardless of how the board selects the chair:

The governance committee chair needs to be a person of vision, independent judgment, leadership, experience, and integrity, who understands governance and who has adequate time to devote to the work of the committee.

Vision. In leading the governance committee, the chair must always bear in mind why the committee exists: to support the board enhancing long-term company performance through mutually beneficial relations with shareholders and other stakeholders.

Independent Judgment. The chair should be a person free from conflicts of interest or obvious biases in matters material to the company. He or she should understand the need for objective judgment, maintaining good relations with management but always exemplifying and promoting an objective mindset.

Leadership. The chair of the governance committee must be able to conduct meetings effectively and efficiently and to encourage others to engage in dialogue without unduly influencing them.

Experience: Governance experience, a strong sense of perspective, and solid understanding of the company are needed in order to lead the board and work with management to foster positive long-term company performance.

Integrity. Because the governance committee is a general policy-making committee, difficult decisions often fall to it. The chair must possess a high level of integrity to lead discussions of such issues, and to help ensure that all board members have integrity as well.

Familiarity with governance issues and processes. Concepts such as independence, accountability, and stakeholder relations must be more than words to the governance committee chair; they must be articles of firm belief and decisive action.

Availability. The time commitment for governance committee service is growing as governance oversight becomes more demanding.[2] A company in crisis or in flux may have significantly higher time requirements than other companies and the chair should be prepared for this possibility. Also, the chair should have adequate time to meet with key investors.

DUTIES OF THE GOVERNANCE COMMITTEE CHAIR

Once the committee is established, and a chair is elected or appointed, the chair can begin his or her work. Certain duties are central to the work of the governance committee chair: ensuring appropriate size and membership of the committee; planning the annual committee calendar; setting meeting agendas; requesting committee reports and ensuring thorough board discussion; presiding over meetings of the committee; communicating with director candidates; and being a liaison in CEO evaluation and in other communications with the CEO. If the governance committee chair is the lead director, then he or she will also plan the annual board calendar.

Ensuring Appropriate Committee Size and Membership

The typical governance committee has three or four members. In fact, many governance committee charters state that the committee "shall be composed of not less than three members of the board." The governance committee chair, with input from the other committee members, determines the committee's size and membership.

There are no special criteria for service on this committee except, like the audit and compensation committees, all members must be independent. The New York Stock Exchange has developed a good working definition of independence.[3]

Independence is important for the governance committee, other key committees, and for the board as a whole. Yet this independence is only a means to an end, not an end in itself.

Planning the Annual Board and Committee Calendar

The governance committee chair needs to develop a good sense for the work of the board, and help to plan how this will be accomplished over the course of the year.

The chair of the governance committee should submit to the board a master calendar of standing agenda items for the full board (in consultation with the board chair) and board committees (in consultation with committee chairs).

Over time, boards have developed a common practice of meeting at least quarterly, with a concomitant practice of at least quarterly meetings for standing committees—though as committee work has increased, these committees often meet more frequently.[4] Key committees, such as audit, compensation, and governance, are meeting more often—generally as many times as necessary to ensure effective oversight. Furthermore, all board and committee meetings should include executive sessions.

The governance committee chair should guide the chairs of other committees as they create calendars for their work, and of course create a calendar for the governance committee. The chair should then incorporate the board calendar and committee calendars into one master calendar, and send it to directors for their comment. (See **Appendix B** for a sample master calendar.)

Setting Meeting Agendas

Beyond drafting a master calendar for board approval, the governance committee chair will work with the board chair or lead director to look at current issues that need to be addressed and placed on the agenda for each meeting. The governance committee chair, or board chair/lead director, should then circulate the agenda for comments from other board members before it gets finalized.

If directors or others raise urgent topics that cannot be covered in the meeting, and cannot wait until the next meeting, the governance committee chair should schedule a special interim meeting, in person or via teleconference. Such interim sessions should be reserved for true emergencies and used sparingly for more ordinary matters. Alternatively, the committee chair can assign individual directors the responsibility of researching a specific issue and bringing it back to the board for inclusion, if appropriate, in a subsequent agenda. Part of the importance of such a response is to give all board members the sense that their contributions are valued.[5]

As they work together with board chairs or lead directors to set meeting agendas for the full board, governance committee chairs should be mindful of the value internal managers can bring to discussions due to their specialized company knowledge. Managers need not be present for the entire meeting, as this can put a damper on the candid dialogue between the CEO and the board.

Supporting the Work of the Board Chair

The previous discussion may create the impression that there is very little work for an independent board chair to do. Yet the board chair does indeed have a role, and one of the functions of the governance committee chair is to ensure that it is accomplished.

The governance committee chair should support or augment the work of the board chair, never compete with it.

The governance committee chair can help the board chair ensure that directors know all the names of senior managers of the company, and hear from them on a regular basis. Furthermore, he or she can support the board chair in making sure that the board receives the full benefit of the work of its committees. The board chair, with the support of the governance committee chair, can ensure that committees report the results of their work to the board, and that the board reserves adequate time for discussion of these reports to the board—particularly reports on critical items.

Presiding Over Committee Meetings

The chair of the governance committee should have experience in running meetings. He or she should know the basics, such as sending the agenda in advance, grouping related items, starting and ending on time, encouraging participation, preventing domination by strong personalities, and respecting parliamentary procedure—even if only informally.

Presiding Over Meetings of the Independent Directors

Current New York Stock Exchange (NYSE) listing rules require boards to hold executive sessions and require companies to disclose the name of the person presiding at these executive sessions. This presiding director need not be the same person for every session (although NACD reports have recommended continuity).[6] If the governance committee chair serves as lead director, this role often falls to him or her.

The NYSE listing rules also require companies to publish contact information for outside directors. These requirements, which are posted on the official websites of both the NYSE and the SEC, include a section on the role of the presiding director in executive sessions.[7]

Helping to Determine Board Leadership

As stated at the outset of this chapter, one of the most important issues for any board and governance committee is determining its leadership structure. When a board has a combined chair and CEO, someone needs to represent the independent directors. That person is usually referred to as a lead director. It is notable that the duties of the governance committee chair detailed here are usually expected of a lead director. Thus it makes sense to have the governance committee chair serve in this capacity.

If the board has a combined CEO/ chair and has not designated a lead director, the chair of the governance committee should hold that title.

The governance committee can help the board decide:

- if it will have a separate chair or a lead director
- whether the lead director will be the governance committee chair (recommended for many circumstances)
- whether the independent chair will also serve as governance committee chair.

The committee can also develop job descriptions for such roles.[8]

Whatever his or her title, no one should usurp the authority of any individual serving as the chair of the board. An effective governance committee will not overstep the boundaries of its role, and can in fact help the board chair exercise the authority granted to him or her by the bylaws. For a chart detailing the differences among leadership roles, see **Appendix C**.[9]

Chapter 3
Setting Governance Policy and Board Structure

Key recommendation:

- ***The governance committee should be given clear authority to shape and recommend to the board policy and board structure, and should devote the necessary time and resources to do so.***

Of all the tasks required of the governance committee, determining the policies and structure of the board may be the most basic. At the same time, these tasks are far from simple. They require a high degree of understanding—of the company and of its business and regulatory environment.

Developing governance policies entails more than reviewing and updating the charter, bylaws, and code of ethics. It also means determining and disclosing governance guidelines for the board—supplemented as needed by additional policies for other matters. And it means overseeing the development and disclosure of charters for each of the board committees.

Similarly, determining board structure involves more than maintaining the regular standing committees (audit, compensation, and governance), and deciding whether or not to have an independent chair. Today, boards are more likely to exercise individuality in forming their committees and their leadership in response to various risks and strategic planning.

SETTING GOVERNANCE POLICY

Unless an organization is a startup, governance committee chairs typically inherit:

- A corporate charter explaining the purpose of the company.
- Bylaws explaining core issues of governance, such as how directors are elected.
- A code of ethics that applies to directors, officers, and employees (some companies publish an additional code specifically for directors).
- A set of governance guidelines that provide additional guidance on how the board will operate.

All of these documents, taken together, comprise governance policy. The governance committee should ensure that these documents are up-to-date, and that all directors are familiar with them. A small number of boards have a separate policy committee; however, given the tremendous load on governance committees today, the number of specific "policy committees" may grow.

The governance committee should be looking for best practices as they evolve, and review the guidelines annually to see if any upgrades are warranted. The committee should strive to emulate boards that practice the most effective governance possible for their situations.

"Best Practices" for Governance

As a part of proposing or approving governance policies, directors, board advisors, investors, and others often identify and promote "best practices," a term used throughout this report.

It is important to note that "best" practices for governance evolve over time and may differ in their importance and application. For this reason, the Delaware courts have wisely noted that "best practices" *should not be used as a standard of liability.*

Chancellor William Chandler of the Delaware Chancery Court, in a decision upheld by the Delaware Supreme Court[1], urged directors and officers to employ "best practices, as those practices are understood at a time a corporate decision is taken." But he added that "Delaware law does not—indeed the common law cannot—hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices" and continued:

> Times may change, but fiduciary duties do not. Indeed, other institutions may develop, pronounce, and urge adherence to ideals of corporate best practices. But the development of aspirational ideals, however worthy as goals for human behavior, should not work to distort the legal requirements by which human behavior is actually measured.[2]

Although "best practices" should not be used as a standard of liability, there is certainly value both in the development and the implementation of them. All organizations need benchmarks and ideas for improvement.

Governance Guidelines

Governance committees play an important role in summarizing the most important board practices as a set of written guidelines. The following subjects *must* be addressed in the governance guidelines for companies listed on the NYSE:

- Director qualification standards
- Director responsibilities
- Director access to management
- Director compensation
- Director orientation and continuing education
- Management succession
- Annual performance evaluation of the board.

Governance guidelines may also address these additional items, which are not required under NYSE listing rules, but which may be advisable:

- CEO continuation on board after retirement
- CEO or senior officer membership on other boards
- Director conflicts of interest
- Director attendance
- Director conduct/ethics
- Director stock ownership
- Insider trading
- Compliance

This is only a short list. Most companies have guidelines that cover a wider terrain. Ideally, guidelines or policies will be simple and all in one place, creating an accessible reference, which should be reviewed at least annually. The governance committee should be looking for best practices as they evolve, and review the guidelines annually to see if any changes are warranted.

It is beyond the scope of this report to provide detailed guidance on all of these policies. The important point here is that governance committees should ask themselves what policies their board needs, and ensure that the policies are developed in a fair and inclusive manner, with full disclosure of policies and rigorous adherence to them.

Governance committees today work according to a rough template suggested by SEC rules applying to all public companies, and by rules for companies listed on the New York Stock Exchange, NASDAQ, and the American Stock Exchange. Private companies and nonprofit organizations are free to organize themselves as they wish, but many are choosing to follow the public company template and trends. For one example of governance guidelines, see **Appendix D.**

Directors and Officers Insurance Review

Before leaving the subject of policy, it is appropriate to raise the topic of directors and officers (D&O) liability insurance. As a committee involved in recruiting and developing directors, the governance committee is in a good position to review the D&O insurance policy to make sure the protection is adequate, both for the entire board and for individual directors. The committee should encourage all directors to read and understand the policies.

SETTING BOARD STRUCTURE

In addition to setting board *policy,* the governance committee also plays a key role in establishing the board's *structure*—its leadership, membership, and the committees needed to execute the work in an efficient manner.

The full board delegates this work to the committee and must also approve the committee's plan. The degree of leadership the committee exercises will depend on the board's leadership structure.

Determining Board Size

How many directors will be on the board? Over the past three decades the average size of public company boards has gone down by about half—moving from a typical size of 16 or more to 8 to10 today, depending on company size, largely because boards wanted to create a more manageable group for decisions.[3] Governance committees need to choose the size that permits the board to have the expertise it needs and form the standing committees, without becoming too unwieldy for group decisionmaking purposes.

Board Membership Policies

Boards need to find ways to ensure that their membership continually anticipates their companies' strategic needs. When setting policies to encourage rotation off the board, the committee must balance two competing (but equally critical) factors: a) the benefit of continuity of the experience that accrues to long-tenured board members; and b) the need for new expertise and diversity of thought, background, and demographics.

The governance committee should give serious consideration to all means of achieving director rotation to and from board and committee service, while valuing board and committee continuity and history.

Age and Term Limits. Traditionally, most boards set a retirement age for directors, and the age they set was not far behind the one set for their companies' executives. In recent years, however, given the challenge of retaining and recruiting the best possible directors, some boards have ended mandatory retirement ages; today only about half of all boards use them. Also, boards are setting a more advanced age as their cap. In the 1990s, most set the age limit between 65 and 70.[4] That number is increasing steadily and now averages about 72, with 75 or even 80 set as the limit on some boards.[5] Term limits remain a minority practice.[6]

Resignation Upon Change In Professional Status. Some boards require submission of a resignation letter when a director's professional status changes. If a board recruits someone because of his or her connection to a particular industry or institution, then the contributions of that director may not be as vital if the director leaves that environment. The committee, in conjunction with the full board, should set a policy that delineates:

- To whom the resignation letter should be sent (e.g., the board chair or the chair of the governance committee)
- Whether acceptance of the resignation will be automatic, and
- If acceptance is not automatic, the procedure to be followed to accept or reject the resignation.

Annual Elections. Proxy voting advisory companies tend to favor annual shareholder elections for all directors.[7] (This is in contrast to having classes of directors who are elected for staggered terms, the situation for about half of all public companies.)[8] Annual elections can give the board the opportunity to ask particular directors not to stand for reelection. If a board has a meaningful annual evaluation process, this can be a powerful tool for keeping the board current. However, governance committees should exercise caution in this area, seeking advice of counsel before changing their director elections policy.

Evaluation. A significant number of boards and governance committees today use evaluation, rather than retirement policies or term limits, as the way to rotate directors.[9] In fact, evaluation is the best way to rotate directors, and it is most effective when approached with a positive mindset. The purpose of evaluation is not to root out "bad" or "underperforming" directors. Rather, it is to see if the board membership serves the strategic needs of the company. Making evaluation and rotation a regular occurrence lessens the stigma of director turnover.

Determining Resignation Policies

Directors choose to resign from boards for a variety of personal and professional reasons. If directors resign voluntarily for personal reasons, it is obviously prudent to accept the resignation. But not all directors voluntarily resign when resignation would be in their own—or the board's—best interests.

The governance committee should consider whether a formal resignation policy is in the interests of the company—including one that would support a move toward majority voting.

Such a policy could require a director to submit (for consideration) a letter of resignation if:

- Evaluations indicate they are clearly not meeting established standards
- Poor health affects the director's ability to serve
- The director's conduct inside or outside the boardroom reflects poorly on the company
- The director undergoes a career change
- The director fails to receive a majority of votes cast for his or her seat.

The governance committee can then recommend a course of action to the board: whether to accept the resignation or not.

As part of its work in succession, the governance committee may wish to define an informal "chain of leadership" policy for the board in the event of the unexpected departure of a board chair or committee chair, allowing an announcement of a departure to be accompanied by the announcement of a replacement. If boards change their leadership structure at the time of a departure (whether as a cause or as an effect of the departure), they can take this occasion to explain the governance benefits of the change.

What Committees Should the Board Have?

As mentioned in the discussion of developing governance policy, unless a board is brand-new, the governance committee inherits a board structure. Whatever that structure may be—whether of three standing committees or a dozen—the committee should conduct a thorough evaluation of how that committee structure is working in relation to the needs of the organization, adding value to board decisionmaking and to management.

Limitations on the Power of Any Committee

As the meaning of governance broadens and the use of committees intensifies, some might ask which duties comprise the explicit responsibility of the plenary board and which duties may be delegated to a committee, management, or other party. State corporation statutes differ on this issue; seek the guidance of counsel to determine the laws of your company's state of incorporation.

Checklist for Evaluation of Board Structure

The following questions make a good checklist for the evaluation of board structure:

- Why does our board need committees—beyond the ones our bylaws and relevant listing standards require (e.g., audit, compensation, governance)?
- What committees do we currently have?
- What do these committees do?
- What committees do we truly need?
- What will these committees do?

The NYSE requires companies to have independent committees for audit, compensation, and governance, and requires these committees to disclose their charters. Furthermore, it tells these committees what they must include in their charters at a minimum. (For a sample governance committee charter see **Appendix A.** For sample audit and compensation committee charters, see the NACD Blue Ribbon Commission reports on those committees[10], or visit the website of any NYSE-listed company.)

Authorizing Ad Hoc Committees

When companies take a new tack in their strategy or face a crisis or transformative event such as a merger, it is good practice to set up an ad hoc committee.

The governance committee should consider the value of ad hoc committees for knowledgeable and focused attention to specific and time-sensitive issues facing the board.

After the ad hoc committee has served its purpose, the committee should be disbanded.

Committee Membership Rotation Policies

The governance committee usually sets policies for committee rotation, reviewing them with the chairs and members of each committee and submitting them to the full board for approval. The committee chairs themselves are usually nominated by the governance committee, requiring the endorsement of the full board.[11] Rotation policies should not be overly rigid, since some committees may have a requirement for expertise; for example, the requirement under Sarbanes-Oxley Section 407 to disclose whether there is an "audit committee financial expert" on that committee.

SUPPORT FROM GOVERNANCE PROFESSIONALS AND ADVISORS

As this chapter has illustrated, the governance committee has a great deal of organizational and administrative work to do on behalf of the board. The recent increase in such duties over the past several years has given rise to a new category of professionals who refer to themselves as "governance professionals."

These new governance professionals can play a strong role in supporting all board committees in the accomplishment of their roles. Traditionally, these governance professionals had the title of corporate secretary (or assistant corporate secretary). Such individuals often had law degrees and worked with or served as general counsel (or assistant general counsel). Today there are senior level employees who hold the title of chief governance officer or corporate governance manager. Reflecting such changes, the former American Association of Corporate Secretaries is now called the Society of Corporate Secretaries and Governance Professionals. At the discretion of the committee, support work can be delegated to these professionals.[12]

In addition, some governance committees engage external advisors that specialize in governance issues such as board or director evaluation, or succession planning.

The governance committee should consider the use of advisors when it is reasonable to do so, but as with any advisor should not abdicate its authority.

Whatever approach to policy development and use of advisors a board chooses, it should articulate that approach and include it in the company's governance guidelines. This is one of the main functions that a governance committee can perform. The next chapter will provide additional guidance on succession policies.

Chapter 4
Planning Director Succession

Key recommendation:

- ***The governance committee's search for new director nominees should be ongoing, and based in the current and emerging strategic needs of the company as understood by management together with the board.***

The governance committee needs to ensure that the company has directors who meet the company's strategic needs and who can hone the board's effectiveness over time. In addition to identifying leaders for the future, the governance committee needs to be prepared for unforeseen departures of board leaders. In today's environment, the process by which directors are identified is an increasingly important one. This process must be a transparent one that takes into consideration the needs of the board and looks to a variety of resources—board members, recruiters, and shareholders—to surface the best candidates. This chapter offers guidance on best succession practices for the board.

NOMINATING DIRECTORS

The SEC requires boards to disclose their nominating processes and results. These requirements, combined with constant shareholder pressure to become more involved in director nominations, should place this issue high on the list of board priorities. Although *current* directors may believe their boards have effective nominating processes,[1] *potential* directors may question this belief. There are still many qualified professionals who have a lot to offer boards who have never been asked to serve on one, simply because they don't know anyone who is in a position to recommend them. An effective governance committee can help connect the board to talent beyond the sphere of acquaintances and celebrities.

The director nomination process is a job for the full board, including its CEO. While delegating nominations to a committee (or even a subcommittee) can be entirely appropriate, boards should remain engaged, in consultation with senior management as needed. The full board should discuss this subject thoroughly, defining parameters and goals, before delegating it to a committee. The committee then proposes the names of candidates for board approval. See **Appendix E** for a sample nomination policy disclosure.

In recent years, shareholders have complained that boards are not taking their suggestions and votes seriously enough. In response, as detailed in the Introduction to this report, shareholders have sought to force changes in the director nomination process, both through shareholder resolutions favoring majority voting and through amendment of the proxy rules to allow for director shareholder nominations. This shareholder movement has intensified the importance of recruiting new board members.

Governance committees should promote open dialogue with shareholders, and send a clear message that shareholders' nominations are welcome and will be treated with due consideration.

Taking a proactive approach to communication with institutional investors will help to foster an ongoing dialogue.

Board Needs[2]

Before the search for a new director can begin in earnest, a board must define exactly what qualities to look for in candidates. The simplest method is to replace the skill set of departing board members as they leave. Yet such an approach does not take full advantage of what is, potentially, a tremendous opportunity.

Ideally, the board will have been involved with the CEO and senior management team in the setting of a business strategy for the company. It is impossible to know which characteristics to look for in a potential board member without knowing the overall direction and strategy of the company.

Once the overall business strategy has been set, the board must understand and articulate its role in helping to achieve the desired goals. As strategic needs of companies vary, so too will the qualifications sought in directors.

The governance committee, in conjunction with the entire board, should continually evaluate how board composition fits with the strategic direction of the company.

This means studying which competencies are currently on the board, and which ones will best serve the board in the future. Of course, the committee should seek individuals with sound judgment and business acumen in the interests of the company, rather than those with narrow skills.

The board should be mindful of the role director education can play in this process. It is not always necessary to find a new director to provide a particular area of expertise; sometimes an existing director may be able to fill the need if he or she receives additional education. For example, if a board decides it wants a member with current expertise in intellectual property, and already has a good general business lawyer among its ranks, it could consider sending that director to a comprehensive program on emerging issues in intellectual property. (For more on director education, see **Chapter 6.**)

An honest and thorough inquiry into the knowledge and skills needed for a strong board should include the identification of certain core factors, such as business acumen, as well as specific skills, such as financial expertise. Many boards find it useful to "develop bench strength," with several board members possessing similar competencies. As a useful tool, the governance committee can develop a board matrix to compare knowledge, skills, experience, and personal attributes the board has versus what it needs, so the board can fill deficiencies through education and succession.

In the example to page 28, the board uncovered a deficiency in international marketing and should consider seeking a director with this expertise. Depending upon how critical the deficiency may be to the company's strategy, the committee can decide to enlarge the board immediately, or wait for an opening through periodic turnover to accommodate the new director.

Developing a Candidate Profile

Once the existing strengths and weaknesses of the board have been evaluated, the search for a new director can begin. The first step is defining exactly what to look for in candidates.

There should be two sources of specifications: the general criteria articulated in the board's governance guidelines, and the more specific criteria that emerge from completing the matrix exercise described above.

The profile for a new director should be as precise as possible. The more specific the description and desired qualifications, the easier and more productive the search will be. Setting broad qualifications will often leave the committee sifting through a glut of candidates. Narrowing the specifications will expedite the process and, more importantly, lead the committee to candidates who will be the best fit for the board.

Engaging a Search Firm for Director Search

Recruiting directors can be a demanding process. For this reason, many boards use professional search firms. This is a common practice among large public companies, but relatively rare for smaller and/or private companies. In general, the benefits appear to outweigh the drawbacks.

STEPS TO CREATING AN EFFECTIVE BOARD EXPERTISE MATRIX

- List the areas of expertise needed on the board in order to be effective in three to five years. This list will vary greatly by industry and other factors, and may include different areas of expertise, education, and diversity of background.
- Apply the list to all current board members. (One approach would be to rate all board members on a scale of 0-10, totaling the board score for each area on the list.)
- Note which areas could use improvement or reinforcement.
- Keep in mind the areas of current board deficiencies when considering potential board members.
- Also keep in mind any openings that will automatically occur as a result of any director rotation policies (e.g., term or age limits). If the board needs marketing expertise, and if the only board member with such expertise is nearing the end of service, it is time to recruit someone who scores highly for that area.
- Keep the matrix evergreen by updating it at least annually to reflect any changing needs of the board.
- Items to consider include: the strength of the management team, nature of the enterprise, value drivers of the business.

The tool should be used to generate discussion and analysis.

The governance committee should consider engaging reputable executive search firms to find director candidates, when appropriate.

Benefits of Using a Professional Search Firm

- Considers a larger pool of potential candidates
- Saves time (process is generally completed more quickly)
- Reduces burden on directors
- Avoids difficult task of rejecting people approached but not selected
- Lessens potential for bias; removes influence of current directors' social connections
- Improves diversity and broadens potential skill base by providing a broader pool of candidates from around the world and from deeper down in organizations (candidates from sources nominating committee members might never have thought about)

Drawbacks of Using a Professional Search Firm

- Surrenders some degree of control over the process (depending on how the board handles its part)
- May require more board/committee time (as compared to an informal process)
- Costs money (unless search firm is working pro bono, which does occur in some not-for-profit situations)

STEPS IN THE SEARCH PROCESS

Whether or not the committee decides to engage a search firm, the search for a new director will comprise several phases: the organizational review or consultative process; the interview process and background check; and the candidate selection and presentation of offer. The following discussion assumes the engagement of

SAMPLE BOARD EXPERTISE MATRIX

	Smith	Jones	Davis	etc.	Total
E-Commerce	4	3	6		13
Acquisition Experience	8	7	7		22
International Marketing	2	3	1		6
etc.	6	7	8		21

For a more detailed example, see **Appendix F**.

Legend: Names of current directors are on the horizontal axis and the skills considered important over the next 5 years on the vertical axis. Directors are rated on a scale of 1 to 10, where 1 indicates low expertise and 10 denotes extraordinarily high expertise, for each area.

a consultant. If the committee and board decide to "go it alone," the process is the same, but the work must be apportioned among committee members, rather than delegated to the consultant.

The Consultative Process

The initial consultative phase is arguably the most important in search engagements. Within this phase there are several steps.

Discussing strategy. During this phase, the recruiter meets with the board, or with the committee responsible for overseeing the search. Together they discuss the company's strategy, goals, and culture. In many cases, directors refer the recruiters to people inside the company who can provide more in-depth perspective.

Setting specifications. The search consultant then creates specifications for the desired position. A good search firm leverages its experience with previous engagements to help the board assess its demands, qualifications, and expectations of the position in light of marketplace realities.

Identifying sources for candidates. The committee and recruiter will identify the most likely sources for candidates by discussing backgrounds, knowledge, competencies, and other related information. Focal points include industry segments and job categories most likely to yield appropriate candidates.

The best search firms can draw from a worldwide network of prestigious contacts. At the same time, they can serve as a reality check if the searching group is setting its sights too high.

Candidate Identification and Review

Based on the position specifications and the board's stated criteria and preferences, the search firm then identifies an initial slate of qualified candidates derived from suggestions made by board members and the firm's own network of executives.

The search firm then considers each candidate for pertinent experience, skills, and cultural fit. Potential conflicts of interest must also be identified. As a next step, the recruiter approaches suitable candidates, directly and confidentially, to gauge their interest. Established search firms will have access to a wide variety of experienced individuals and will also have a sense of these candidates' goals—and receptiveness to the particular opportunity. Some candidates will prefer that directors make the initial contact.

During this time—and throughout the engagement—the chair of the governance committee (or search committee) should contact the search firm if additional or different information concerning the director position emerges. The committee should expect the search firm to work quickly and efficiently. Upon conclusion of the candidate identification and review, the search firm typically delivers a full status report to the board.

The Interview Process

The interview process is perhaps the most difficult and demanding portion of any director search. It could also very well be the most important. Going beyond the obvious questions regarding experience and expertise, a skilled interviewer can ascertain a candidate's commitment to the company, ability to mesh with the existing board, and other intangible qualities essential to a successful board member.

In order to maximize what can be learned from the interview process, the governance committee should make sure that each candidate is well informed about the company. For example, the governance committee can ensure that each serious candidate receives a briefing book about the company with information about the company's strategy, performance, governance procedures, and current directors.

Once a candidate is identified, a series of interviews is conducted, so that a candidate's skills, interest level, and cultural fit with the board can be assessed in detail. This can be a lengthy process because it can be difficult to coordinate the schedules of board members, the CEO, and others with the candidate.

If a search firm is involved, the recruiter will typically take the first interview, to get a sense of whether the candidate has the expertise, willingness, capability, and chemistry with the existing members to effectively serve on the board. Then he or she will coordinate the interviews to follow with board members.

Serious candidates should be afforded the opportunity to meet the CEO, board chair, and other directors early in the process. Such a meeting, besides giving the head of the company an early chance to get acquainted with the candidates, will serve to generate excitement in the candidate about the possibility joining the board. This is also a good opportunity for candidates to ask questions, and if things go well, come to respect and trust the CEO–an integral step in recruitment.

Board members engaged in the interview process have a dual role. On the one hand, they are "selling" the company to prospective directors, and on the other hand, they are evaluating those directors. Board members must look for certain qualities in potential peers, especially intangible traits like willingness to be a team member and ability to interact easily with existing board members.

Although meetings with the candidates are imperative, they should be kept to a minimum. More than two or three rounds of interviews will only lead to doubts about the company's intentions and the candidate's potential role.

All board members should be offered the opportunity to meet each candidate for the board.

Background Checks

Informal background checks. During the search process, it is essential to do informal background checks on the candidates. Conversations with current and former co-workers, superiors, and subordinates, as well as non-professional acquaintances can provide valuable insight and help verify (or disprove) the personality traits a candidate showed during interviews. As part of the informal checking process, the board can seek assurance that the candidate is not serving on too many boards or key board committees. In particular, if a candidate serves on more than three audit committees, boards must determine that this service does not interfere with their board service.[3]

In addition, someone needs to check to ensure that there are no conflicts of interest or interlocking directorates that would prevent the board members from meeting the independence requirement.

Formal background checks. At some point more formal background checks will be in order. A first step in this phase may be a conversation with the CEO of the candidate's company (or, if he or she is CEO, then the chair). Also important are reviews of criminal and civil records dating back at least a decade. Usually, the search firm will verify candidates' academic records. Further checks are the responsibility of the company. The governance committee should consider a standard process for ensuring they are not surprised by anything in the candidate's past.

The Selection Process

If the board has engaged a search consultant, the board/committee shares with the consultant all interview feedback, which the consultant augments with an analysis of the candidate's strengths and ability to meet the company's current and future needs. Before candidates are presented, the search firm verifies their educational credentials; as soon as a clear choice emerges the firm performs formal reference checks and reports their findings to the board.

Candidates may have their own requests as they complete their due diligence, asking to speak with additional directors, senior management of the company, or outside auditors. The governance committee can help to schedule such meetings.

The CEO should be included in this process. This Commission believes that building a consensus among all board members before the final decision is made can lead to an easier and more confident appointment process. While no individual board member should have veto power, the board should try to reach consensus on candidates. A recommendation by the governance committee will go a long way toward giving the newest director credibility with the full board.

Extending the Final Offer

When the time comes to formally offer the directorship to the candidate, a member of the board–not the CEO–should present the offer. Most commonly, the non-executive chair, lead director, or governance committee chair will extend the offer. At this point, the extension of the offer should be merely a formality.

Chapter 5
Overseeing Evaluation of the Board, Directors, and the CEO

Key recommendation:

- ***The governance committee should evaluate itself and spearhead the board evaluation process.***[1]

The governance committee has an important role in the evaluation of the board—as well as the CEO, in conjunction with the compensation committee. The development of an evaluation process often occurs in stages—building from CEO evaluation to full board evaluation, individual director self-assessment, and, finally, peer evaluations. CEO evaluations are nearly universal,[2] and a majority of companies conduct full board and committee evaluations; individual director evaluations are still a minority practice.

BEST PRACTICES FOR BOARD SELF-EVALUATION

Companies listed on the New York Stock Exchange are required to have an independent "nominating/corporate governance committee" with a charter that addresses the committee's purpose and responsibilities, which must include among other things *overseeing the evaluation of the board and management.*[3] In addition, each governance committee must evaluate itself every year.

Board and Committee Self-Evaluation Process

The evaluation process starts with the board's commitment to board performance improvement. As evaluation progresses, it must serve one clear objective: to provide guidance that creates superior long-term shareholder value.

Boards and governance committees have considerable discretion to develop the means of evaluation that will best fit a company's particular situation.[4] While there are many variations on the theme, generally, board and committee evaluations will involve the following:

- The board delegates to the governance committee or other entity/individual the task of developing, proposing for board approval, and implementing a self-evaluation strategy for the board and its key committees.
- The strategy typically involves obtaining and discussing director viewpoints about board and committee performance: (i) through use of survey forms or interviews to gather viewpoints which are then digested into a written or oral report, followed by a full board/committee discussion of the results; or (ii) through

a more simple, streamlined process involving a facilitated board/committee discussion. The former allows directors to express their viewpoints confidentially, while the latter is more streamlined.

- A third party may be relied on to assist – often a lawyer, so as to preserve an argument that communications are privileged (However, there is no assurance that a court will recognize privilege in these circumstances.)
- Through the discussion, the board and each committee may (or may not) identify specific areas in which changes to processes and procedures would provide benefits.
- Finally, and most importantly, the board and each committee follow up on implementing any recommended changes. (This may involve delegation of further study, or other work and implementation to the governance committee, especially as to changes aimed at board processes.)

Whatever format is used, the goal should be to engage the full board in deliberation and discussion about how the board functions. Board deliberation and discussion are keys to a productive evaluation.

Board minutes should reflect that the evaluation was undertaken but need not reflect much else (unless there is a clear action item—for example, "It was agreed that the governance committee should review and recommend ________ to the board.").

For a sample board and committee self-evaluation form, see **Appendix G.**

Committee Self-Evaluation Requirements

Under New York Stock Exchange guidelines for audit, compensation, and governance committees, each key committee must evaluate itself annually. The governance committee is largely responsible for ensuring that the board itself and all board committees have clearly defined duties and a process for fulfilling them.

The NASDAQ Stock Market has only one requirement pertaining to committee self-evaluation, which is that each NASDAQ-listed company must "certify" that it has adopted a formal written audit committee charter, and that the audit committee has reviewed and reassessed the adequacy of the charter on an annual basis.

Individual Director Evaluations

Individual director assessments are a delicate matter requiring the utmost levels of tact, candor, and confidentiality. NACD has issued a separate Blue Ribbon Commission Report on that subject.[5]

The sources of individual director evaluation may be the director him or herself; peer directors; the board chair/lead director; or the governance committee. Like full-board evaluations, the focus of individual director evaluations should be on performance and not on personality. External advisors may be used to help establish a process for evaluation, but should not conduct individual director evaluations. Unlike peer directors, an external consultant would not have the opportunity to see the director in action.

Boards should restrict distribution of evaluation results to the board chair, governance committee chair, and the individual director involved. The board should maintain a record of the evaluation process, but should destroy records of individual director evaluations.

BEST PRACTICES FOR CEO EVALUATION

No task could be more central to the board's mission than ensuring that the CEO, as the *sine qua non* of corporate performance, is performing to his or her maximum potential. A critical element in this determination is conducting regular evaluations, and as such, CEO evaluations are the responsibility of the plenary board. However, boards should choose a committee to take the lead in the evaluation; most commonly, either the compensation committee or the governance committee does so. In some cases both committees' duties may be too extensive to take on the complex and time-consuming task of CEO evaluation. In such situations, the process may be delegated to an independent committee dedicated to these tasks.

Whether or not the governance committee takes the lead in CEO evaluation, the committee, as chief overseer of board governance, is a vital link between the CEO and the board. As part of its primary mission to drive excellent governance and company performance, the governance committee should help insure that the board dynamic is as constructive as possible. Encouraging debate and discouraging cliques or factions will help create an atmosphere wherein the CEO is most likely to be successful.

The governance committee must ensure active and knowledgeable board oversight and support for the CEO's work.

As they do their evaluation work committees will find it useful to ask two questions (among others): *Is our CEO building long-term economic value for shareholders?* And, just as important, *how can the board help the CEO and senior managers achieve this goal?*

The governance committee, working with the compensation committee and the board, should define and communicate a process for CEO evaluation based on clear objectives and metrics, both financial and non-financial. Objectives set for CEO evaluation should be tied to the strategy of the company.

The CEO should set the list of objectives, for board approval. These objectives are used to assess the CEO's overall performance and ultimately to determine his or her compensation. Once the evaluation is complete, one or more members of the board should meet with the CEO to discuss strengths and areas for improvement.

A NOTE ABOUT CEO SUCCESSION

While director succession planning falls squarely within the responsibilities of the governance committee, the same is not true of CEO succession planning. This is a full-board function and should never be delegated to a committee.[6]

SETTING OR REVIEWING DIRECTOR COMPENSATION

Director Compensation: Basic Tenets

The governance committee should recommend to the board which committee will be responsible for setting director compensation—whether it be the compensation committee, the governance committee, or some other committee. Often the governance committee is responsible for setting director compensation and the compensation committee, that of the CEO and senior management. In both cases, the full board has responsibility for understanding and approving the final plans.

For guidance on director compensation, see the *Report of the NACD Blue Ribbon Commission on Director Compensation.*[7] Information on director compensation trends is available from NACD (in an annual Pearl Meyer & Partners study[8]) as well as other organizations.

Directors are peers as fiduciaries with equal responsibilities under corporation law. As such, director pay tends to be much more egalitarian than executive pay. Director pay is awarded according to a role-based formula that does not vary by individual, only by role. The NACD/Pearl Meyer surveys reflect this basic equality.[9]

Board pay typically is a mix of cash and equity, and each board must decide what percentage of each is appropriate. Cash comprises an annual cash retainer, meeting fees, and fees for chairing the board or a committee, or for serving on a particular committee. Equity awards include restricted stock, deferred stock, and stock options.[10]

Some boards pay premiums to directors serving on particularly time-consuming committees.[11] Most public company boards award higher pay for service on particular committees as a member or chair, and many boards award differential pay to directors serving in particular positions, such as lead director or independent chair.

The premiums involved in this differential pay are relatively modest, however, and they always pertain to the position, not to the individual. This makes director pay different from executive pay. If a board is recruiting a CEO or other senior executive, it may increase the salary of a particular position to attract a star performer. In recruiting directors, by contrast, boards rarely use compensation in this way. Such an approach, by creating a "star" director, could be detrimental to board unity.

To be considered independent, directors should receive no pay from their boards other than their director pay. (In other words, directors should not be paid as consultants.) In addition, to align directors' interests with the long-term good of the company and all its stakeholders, director compensation should include long-term equity grants (not options). Boards should strive for a simple approach to director compensation that includes cash and stock, with restrictions on short-term gains.

Stock Ownership Guidelines for Directors

Many shareholders feel that directors and officers should have a meaningful investment in the companies they manage, as directors who themselves own shares are more likely to represent the viewpoint of other shareholders whose interests they are charged with protecting. To help align board and shareholder interests, directors' compensation should include a minimum stock ownership requirement. A review of practices for various companies indicates that each director should achieve an ownership requirement of 3 to 5 times the annual retainer within 3 to 5 years.

Compensation for the Lead Director/ Governance Committee Chair

Lead directors and committee chairs are likely to receive total annual compensation that is higher than their peers, because they chair and/or spend significantly more time in board activities than their peers.[12] Given the responsibilities of the board today, few question this trend.

Chapter 6
Improving the Board Through Director Education

Key recommendation:

- ***The governance committee should ensure that relevant orientation is provided for new directors, and also ensure that continuing education in governance and in relevant business topics is provided for the entire board.***

Director education today goes far beyond the old "director orientation" programs of the past. As their responsibilities intensify, boards are deepening their knowledge about their own roles as directors, as well as about the changing environments for the companies and industries they serve. To provide this knowledge in governance and business, companies are devoting more resources to director education and development, and a key responsibility of the governance committee is to oversee the director education program. This chapter describes trends in director education and offers recommendations for best practices.

Most educational programs focus on content—what a director should know. This includes knowledge of fundamentals and trends in governance and business. A new domain of director education (and evaluation) is the notion of director competencies—what skills a director should possess. These may include financial acumen, conceptual thinking skills, and effective communication and listening skills.[1]

- ***The governance committee should oversee the processes of director orientation and continuing director education, ensuring that directors understand the company's business and industry, as well as fundamentals of business and corporate governance, and have the skills needed to put this knowledge into practice.***

EXTERNAL DRIVERS OF DIRECTOR EDUCATION

Director education at public company boards is occurring in part as a response to several important developments.

Listing Requirements

First, most broadly, stock exchange listing requirements approved after passage of the Sarbanes-Oxley Act in 2002 have increased the "governance content" that directors must master:

- The New York Stock Exchange requires all listed companies to disclose their governance guidelines, which must include (among other items) a description of their "director orientation and continuing education."
- NASDAQ provides directors of listed companies with relevant continuing education opportunities concerning their governance responsibilities.
- The American Stock Exchange has no requirements or formal alliances pertaining to education.

Governance Rating Organizations

Organizations that rate public companies for their governance practices, listed in the introduction to this report, include director education as a factor in their rating systems. Because some rating organizations give points for director education, boards that educate their directors may receive overall higher governance ratings from these organizations.[2]

One of the rating groups, Institutional Shareholder Services (ISS), accredits director education programs. In order to qualify for ISS accreditation:

- The program must be open to all directors.
- The program must consist of a minimum of 8 hours of instruction. The curriculum must focus on improving a company's corporate governance practices.
- The Sponsoring Group seeking to become accredited and submitting application materials must include one or more of the following:
  - a university
  - an educational foundation established for the purpose of promoting best practice corporate governance standards
  - a membership group such as the National Association of Corporate Directors or the Society of Corporate Secretaries and Governance Professionals
  - At least 25 percent of the speakers must be current or former directors of publicly traded companies and no more than 25 percent of the speakers may be service providers to companies.

The D&O Liability Factor

Directors are becoming more concerned about their boards' liability as well as their personal liability as individual directors. NACD's 2005 Blue Ribbon Commission on director liability found that directors bear no increased risk today of being found liable for a breach of fiduciary duty. But the Commission did find that rising stockholder-plaintiff activism has increased the risk of litigation alleging a breach of fiduciary duty. Thus that Commission asserted: "Learning and following best practices is imperative for directors who wish to become empowered guardians and builders of corporate value."[3]

WHAT DIRECTORS SHOULD KNOW

Director Orientation

Newly elected board members can benefit greatly from a formal orientation program that will allow them to hit the ground running. As a result of strict conflict of interest rules, candidates will often join the board of a company in an industry with which they have very little, if any, experience and familiarity. The governance committee should provide a director orientation program for all incoming board members that gives a thorough introduction to the company and its industry sector as well as a tutorial on the board's unique policies, procedures, core values, and ethical standards. (See Boxes.) Integrating new directors quickly will enable the board to take timely advantage of the members' expertise, avoiding a long start-up period.

Core Governance Curriculum

In the view of this Commission, a governance curriculum should include the basic requirements of the director's role as described under pertinent law and listing standards.

In the United States, directors of public companies should learn about the following, at a minimum:

NEW BOARD MEMBER ORIENTATION CHECKLIST

Orientation of: ________________________
Date orientation began: ________________

Describe the organization to the board member:
____ Who we serve
____ What we do
____ Other: ___________________________

Explain and discuss with board member:
____ Meeting attendance – both full board and committee
____ Committee assignments
____ Board role and relation to administrator/staff
____ Other: ___________________________

Conduct tours:
____ Administrative offices and board room
____ Other facilities: ___________________

Deliver important information to board member:
____ Letter of welcome from the chairperson
____ Mission statement
____ Bylaws
____ Board policies
____ Copies of the minutes of board meetings for the past year
____ Annual report and auditor's report for last three years
____ Current budget and other financial reports
____ Area Plan
____ Goals for the year.
____ List of board members with addresses/phone numbers
____ List of board officers
____ List of committee memberships, including chairpersons
____ Calendar of meetings for the year
____ Copies of the organization's newsletters for the past year
____ Other: ___________________________

Introduce board member to:
____ Chairperson
____ Chairperson of committees to which member is assigned
____ Staff
____ Other: ___________________________

Collect data:
____ Address
____ Telephone – home and office
____ Best time to contact
____ Best time for meetings
____ Other: ___________________________

Source: National Association of Resource and Development Councils.

- Fiduciary duties of loyalty, care, and good faith[5]
- Business judgment rule[6]
- Pertinent listing requirements for stock exchanges
- Key cases of director liability under federal securities law (e.g. Section 11 of the Securities Act of 1933 pertaining to public stock offerings and Section 16(b) under the Securities Exchange Act of 1934 pertaining to insider trading)
- Pertinent Sarbanes-Oxley sections including:
  - Stricter standards for independence of audit committees (sec. 301)
  - Corporate (CEO) responsibility for financial reports (sec. 302)
  - Stricter professional standards forcing attorneys to be whistleblowers (sec. 307)
  - Management assessment of internal controls (sec. 404)
  - Requirement for a Code of Ethics (sec. 406)
  - Disclosure of an Audit Committee Financial Expert (sec. 407)
  - Protecting all whistleblowers (secs. 806 and 1107)

Core Business and Industry Curriculum

The governance committee should ensure that directors' business education includes general as well as company-specific components. That is, business education for directors should not just focus on "this business." Rather, it should also teach about the company's industry, and about "business" in general.

With respect to education about the particular company, the business component of director

DIRECTOR ORIENTATION AT GENERAL MOTORS

Director Orientation and Continuing Education

The Board and management will conduct a comprehensive orientation process for new Directors to become familiar with the Corporation's vision, strategic direction, core values including ethics, financial matters, corporate governance practices and other key policies and practices through a review of background material, meetings with senior management and visits to Corporation facilities. The Board also recognizes the importance of continuing education for its Directors and is committed to provide such education in order to improve both Board and Committee performance. The Board acknowledges that director continuing education may be provided in a variety of different forms including: external or internal education programs, presentations or briefings on particular topics, educational materials, meetings with key management and visits to the Corporation's facilities. It is the responsibility of the Directors and Corporate Governance Committee to advise the Directors about their continuing education on subjects that would assist them in discharging their duties, including leading-edge corporate governance issues. Directors are encouraged to attend, at GM's expense, continuing education programs sponsored by educational and other institutions.[4]

education should include instruction about the following items:

- Description of product/service
- Company history
- Company position within its industry or industries
- Competitive environment
- Company strategy
- Operational plan
- Company values/ethics
- Description of product/service
- Any special financial reporting issues.

It is widely agreed that a newly appointed director requires some period of time to become familiar with the industry, operations, and culture of the company. A rigorous orientation program should be undertaken to ensure that the director is "up to speed" as soon as possible.

Financial Literacy for All Board Members

Companies of all kinds are recognizing the importance of financial literacy. While stock exchange listing standards require such literacy for all audit committee members[7], this Commission recommends extending that principle beyond the committee:

The governance committee should require financial literacy of all audit committee members, and should ensure that all directors are financially literate or become so through educational programs.

Five years before the passage of Sarbanes-Oxley, a previous and prescient NACD Blue Ribbon Commission declared that each director should possess financial literacy. Specifically, the report stated: "Boards should seek only candidates who are financially literate. Directors should know how to read a balance sheet, an income statement, and a cash flow statement, and they should understand the use of financial ratios and other indices for evaluating company performance."[8]

SOURCES OF LEARNING

Directors can learn from many sources. Obviously the experience of serving on boards provides valuable "on the job" training. Directors can do their "homework" by reading periodicals, reports, and books, and surfing the Internet for topics pertaining to the issues facing them. Some professional associations offer publications and on-demand research services for members, sometimes at no cost.

In addition, there are several sources of "live" in-person education, including:

- Company-specific sessions that deepen the knowledge of a specific company, its industry sector, and its position within that sector, as well as the culture of the company and its operations.
- Broader seminars and courses on general governance principles and best practices. See the ISS guidelines for accreditation of director education programs, above, as a general guide to course selection.

Both types of sessions may be offered onsite or offsite. Members of the board or management, or outside consultants or other experts, can facilitate.

Conclusion

Experience is the best teacher. Governance committees above all should comprise directors whose lifetime achievements indicate an understanding of and commitment to the core values of governance, as well as a willingness to support continuing education and development of all directors. Such an engaged, committed governance committee will in turn be able to enhance the board's ability to engage in policymaking, succession, evaluation, and education—the fundamental governance tasks of the board and its governance committee. ■

Endnotes

Endnotes are listed by chapter and numbered accordingly for each section.

Foreword from the Chair: Governance at a Crossroads

1 Governance Metrics International has prepared a bibliography of nearly 200 studies that examine the link between corporate governance and returns to investors. Some studies focus on a single issue such as board independence. Others look at the impact of corporate governance across a large number of variables over many years. See http://www.gmiratings.com/ for sample entries. In 2007, NACD has joined the Millstein Center for Corporate Governance and Performance at the Yale School of Management to launch a long-term study of the correlation between corporate governance and performance.

Introduction: The Governance Committee Comes of Age

1 See Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Harcourt, Brace, and World [1932] 1968), a classic study cited in most articles and books about corporate governance.

2 Two current examples, in addition to majority voting, are resolutions to permit cumulative voting and to oppose staggered boards. In the 2006 proxy season, there were relatively few cumulative voting proposals, but there was some movement to oppose staggered boards. The first 60 proposals to eliminate staggered boards received an average shareholder vote of 66 percent.

3 Prepared by Claudia H. Allen, partner and chair of the Corporate Governance Practice Group of Neal, Gerber & Eisenberg LLP.

4 Committee on Corporate Laws, *Corporate Director's Guidebook,* fifth edition. (Chicago: American Bar Association, 2007), at p. 94. This updated handbook addresses directors' fiduciary responsibilities, as well as board and committee, including governance committee, processes and responsibilties.

5 For a transcript of the 2007 roundtables, see http://sec.gov/news/openmeetings/2007/openmtg_trans052407.pdf.

6 See http://www.nyse.com/pdfs/PWG_REPORT.pdf. As we go to press, the SEC has not yet released the NYSE's proposal for comment. Since beneficial owners are more likely than brokers to vote for dissident directors, this change, if enacted, has the potential to trigger more turnover in the boardroom. The impact of this rule will be felt by larger companies that have adopted majority voting, a perhaps unanticipated consequence of the enactment of two seemingly disparate reforms. If both are enacted, the effect of each will be magnified by the other. If beneficial holders are voting their shares under unknown (OBO) identities, this could affect the work of the governance committee as well. For an example of a policy for responding to shareholder resolutions, see http://www.ibm.com/annualreport/2006/proxy_faq2.shtml.

7 The Business Roundtable, National Investor Relations Institute, Society for Corporate Secretaries and Governance Professionals, NACD, and others have asked the SEC to study its existing rule permitting shareholders to remain anonymous when buying shares through brokers. The NACD and others believe that the SEC might well consider making NOBO the default standard. If beneficial owners get the power to vote directly, the anonymity enabled by the OBO rule will become less tolerable to businesses.

8 For a recent comment letter about the NOBO-OBO issue, see http://www.governanceprofessionals.org/commentletters/flash20s.shtml.

9 Some companies were concerned about the potential conflict of interest for ratings organizations that also serve as consultants and asked the SEC to investigate. The SEC delegated this research to the Government Accountability Office (GAO). The GAO interviewed 31 institutional investors plus an unspecified number of governance experts and found potential for conflicts, but no convincing evidence of them. The GAO noted a number of safeguards in use. Based on this research, the GAO recommended that the SEC take no action. The report was released in June 2007 http://www.gao.gov/new.items/d07765.pdf.

10 All of these rating agencies include *governance committee independence and effectiveness* as a factor in their ratings, taking their information from the company's filings with the SEC and other research.

11 See note 1, to the foreword, above.

Chapter 1: Improving Board Performance

1 In small, closely held companies, the functions are still critical, but may be carried out by the entire board, so that no governance committee may be needed.

2 Final NYSE Corporate Governance Rules, Section 303A.

3 See note 2, above. According to the New York Stock Exchange, an "independent director" is one who has no material relationship with the listed company; additional restrictions apply for audit committee membership. A material relationship "can include commercial, industrial, banking, consulting, legal, accounting, charitable, and familial relationships, among others." Source: *Final NYSE Corporate Governance Rules*, http://www.nyse.com/pdfs/finalcorpgovrules.pdf. These have been codified into Section 303A of the NYSE's Listed Company Manual.

4 4350. Qualitative Listing Requirements for NASDAQ Issuers Except for Limited Partnerships
(4) Nomination of Directors
(A) Director nominees must either be selected, or recommended for the Board's selection, either by:
(i) a majority of the independent directors, or
(ii) a nominations committee comprised solely of independent directors.
(B) Each issuer must certify that it has adopted a formal written charter or board resolution, as applicable, addressing the nominations process and such related matters as may be required under the federal securities laws.
(C) Notwithstanding paragraph (4)(A)(ii) above, if the nominations committee is comprised of at least three members, one director, who is not independent as defined in Rule 4200 and is not a current officer or employee or a Family Member of an officer or employee, may be appointed to the nominations committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the proxy statement for next annual meeting subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years.
(D) Independent director oversight of director nominations shall not apply in cases where the right to nominate a director legally belongs to a third party. But this does not relieve a company's obligation to comply with the committee composition requirements under Rule 4350(c) and (d).

5 Amex Company Guide, Sec. 804. BOARD NOMINATIONS
(a) Board of Director nominations must be either selected, or recommended for the Board's selection, by either a Nominating Committee comprised solely of independent directors or by a majority of the independent directors.
(b) Notwithstanding paragraph (a) above, if the Nominating Committee is comprised of at least three members, one director who is not independent as defined in Section 121A, and is not a current officer or employee or an immediate family member of such person, may be appointed to the Nominating Committee , if the board, under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the company and its shareholders, and the board discloses, in the next annual meeting proxy statement (or in its next annual report on SEC Form 10-K or equivalent if the issuer does not file an annual proxy statement) subsequent to such determination, the nature of the relationship and the reasons for that determination. A director appointed to the Nominating Committee pursuant to this exception may not serve for in excess of two years.
(c) Each listed company must adopt a formal written charter or board resolution, as applicable, addressing the nominations process and such related matters as may be required under the federal securities laws.

6 Source: Organization for Economic Cooperation and Development, *Corporate Governance Principles* (Paris: OECD, June 1999, May 2004). (Emphasis added.)

7 SEC Release 33-8177, Jan. 23, 2003. Effective date: March 3, 2003.

8 Note: On May 1, 2007, the U.S. Sentencing Commission sent revisions to Congress. If passed, these revisions would be effective November 1, 2007. See http://www.ussc.gov/.

9 *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del Ch. Ct. 1996).

10 A number of publications are available to help boards and board committees meet these standards. See, for example, Ronald Zall et alia, *The Corporate Directors' Ethics and Compliance Handbook* (Washington, DC: National Association of Corporate Directors, 2003).

Chapter 2: Chairing the Governance Committee

1 (Washington, DC: NACD, 2004)

2 Governance committees of public company boards, on average, meet four times a year, for an average of 1.7 hours per meeting. More generally, the average director today spends 98 hours per

year on total committee work for each board served, plus 112 hours on board work—a total of 209 hours. Source: *NACD 2006 Public Company Governance Survey* (Washington, DC: NACD, 2006). Numbers of meetings are similar for not-for-profit and private company boards, but meetings last longer—more than two hours on average for both. See the *2006 NACD Private Company Governance Survey* and *2006 NACD Not-for-Profit Governance Survey* (Washington, DC: NACD, 2006).

3 New York Stock Exchange standards say that for a director to be considered "independent," the board must have determined that he or she has **"no material relationship"** with the company, either directly or "as a partner, shareholder, or officer of an organization that has a relationship with the company." The board has discretion to determine what would constitute a material relationship. In addition, a director does not qualify as independent if certain "bright line disqualification standards" apply to him or her. Executive compensation rules passed in 2006 amending Item 404 of Regulation S-K:
- expand the definitions of "transaction," "related person," and "immediate family member."
- require disclosure of companies' policies and procedures for the review, approval, or ratification of related person transactions.
- increase the *de minimis* dollar threshold for disclosure from $60,000 to $120,000.
- require disclosure of any recent transaction (proposed since the beginning of the company's last fiscal year) in which the company was or will be a 'participant' if the amount involved is more than $120,000, and any "related person" has or will have a direct or indirect material interest (significant to investors in light of all the circumstances).

4 The average number of meetings held per year by public company boards is 6.4, up from 6.0 in 2005. For private companies, the average was 6.0, and for not-for-profits, the average was 6.2. The average number of committee meetings on public company boards was: Audit Committees, 7.4; Compensation Committees, 4.6; and Governance Committees, 4. Source: NACD 2006 Public, Private, and Not-for-Profit Governance Surveys, cited above.

5 This paragraph summarizes passages from Lorin Letendre and Ann James, *Board Dynamics* (Washington, DC, NACD, 2004).

6 See http://www.nyse.com/pdfs/finalcorpgovrules.pdf, p. 7, for more details.

7 This role is described in NYSE's Listed Company Manual 303A.03 Executive Sessions. http://www.nyse.com/Frameset.html?nyseref=&displayPage=/lcm/1078416930888.html.

8 For more guidance, see *Report of the NACD Blue Ribbon Commission on Board Leadership,* chaired by Robert Hallagan and B. Kenneth West (Washington, DC: NACD, 2004).

9 *Ibid*.

Chapter 3: Setting Governance Policy and Board Structure

1 *In re The Walt Disney Company Derivative Litigation,* No. 411, 2005 (Del. June 8, 2006).

2 *In re The Walt Disney Company Derivative Litigation,* No. 15452 (Del. Ch. Aug. 9, 2005).

3 Larger boards are still typical for not-for-profits. See the *2006 NACD Not-for-Profit Governance Survey* (Washington, DC: NACD, 2006). This survey reports an average board size of 18, compared to a board size of 9 for public company boards reported in the *2006 NACD Public Company Governance Survey* (Washington, DC: NACD, 2006).

4 *1997 NACD Public Company Governance Survey* (Washington, DC: NACD, 1997).

5 *2005 NACD Public Company Governance Survey* (Washington, DC: NACD, 2005).

6 *2006 NACD Public Company Governance Survey* (Washington, DC: NACD, 2006).

7 See http://www.issproxy.com/pdf/2007USSummaryGuidelines.pdf.

8 The 2006 NACD survey trends show a decrease in staggered elections. S&P 500 companies had a decrease to 47.8 percent with classified boards, down from 53.8 percent in 2005. Smaller companies also showed declines in the use of classified boards.

9 Nearly half (45 percent) of all respondents to the *2006 NACD Public Company Governance Survey* said they use individual director evaluation as a means of rotating directors.

10 See *Report of the NACD Blue Ribbon Commission on Audit Committees: A Practical Guide* (Washington, DC: NACD, 1999/2005), and *Report of the NACD on Executive Compensation and the Role of the Compensation Committee* (Washington, DC: NACD, 2003).

11 58 percent of all respondents to NACD's 2006 public company governance survey reported involvement by the governance committee, and 27 percent indicated full board involvement. Less common is chair/CEO involvement (23 percent), or involvement from committee members (10 percent).

12 For example, the professional can have each director and officer complete a directors and officers questionnaire ("D&O ques-

tionnaire") every year. The questionnaire can include: questions on board members' and immediate family members' affiliations, third party relationships and compensation, stock ownership, and other business relationships. The professional can track and summarize the results of these questionnaires and review them with the governance committee (and any other relevant committee) before filing the proxy.

Chapter 4: Planning Director Succession

1 In 2006, less than 10 percent of respondents identified "director succession" as one of their top three issues. Source: 2006 NACD Public Company Governance Survey.

2 The material in this section was provided by Heidrick & Struggles for this 2007 Blue Ribbon Commission report.

3 See http://www.nyse.com/pdfs/finalcorpgovrules.pdf, Item 7(a), at p. 10. NASDAQ has similar requirements at Marketplace Rules, Listing Requirements for NASDAQ Securities, at http://www.complinet.com/nasdaq/display/display.html?rbid=1705&element_id=13.

Chapter 5: Overseeing Evaluation of the Board, Directors, and the CEO

1 This recommendation is already a requirement at the New York Stock Exchange. See http://www.nyse. com/pdfs/finalcorpgovrules.pdf, Item 4 b ii at p. 8.

2 The 2006 NACD Public Company Governance Survey showed these trends :

- Full board evaluation—83.5% (close to the number of boards conducting regular formal CEO evaluation)
- Committee evaluation—77.52%
- Individual director evaluation—45.1%

Note: For more guidance, and for sample forms to use for CEO evaluation, board evaluation, and individual director evaluation (self evaluation and peer evaluation), see *Report of the NACD Blue Ribbon Commission on Board Evaluation: Improving Director Effectiveness* (Washington, D.C.: NACD, 2001/2005).

3 See note 1 above re NYSE requirements for board evaluation.

4 The discussion on board and committee self-evaluation is adapted from a Weil, Gotshal & Manges Memorandum: Holly J. Gregory, "Board & Committee Evaluation," January, 2006.

5 See *Report of the NACD Blue Ribbon Commission on Director Evaluation,* cited above in note 2.

6 For more on CEO succession, see *The Role of the Board in CEO Succession: A Best Practices Study* (Washington, D.C.: NACD, 2006), published in collaboration with Mercer Delta Consulting, LLC, New York [Now Oliver Wyman].

7 Report of the NACD Blue Ribbon Commission on Director Compensation (Washington, D.C.: NACD, 1996/2001/2005).

8 See *2006-2007 Director Compensation Survey,* NACD and Pearl Meyer & Partners, available electronically to NACD members, and in print.

9 In 2005, 40 of the largest 100 NYSE companies paid their lead directors additional compensation; 27 of the 100 largest NASDAQ companies did so. The amount of extra money involved ranged from about $10,000 to about $30,000. http://www.fwcook.com/alert_letters/2005_directorscomp.pdf.

10 Full-value stock awards are now favored over stock options in all but the smallest companies studied. See note 8.

11 In 2006, 75% of Top 200 companies paid board meeting fees. Other sizes of companies' practices were quite similar, ranging from 70% to 76%. Source: *2006-2007 Director Compensation Survey,* cited above in note 8.

12 Median committee chair compensation for all standing committees (audit, compensation, governance) was double or more that of committee members, in all revenue categories, with two very minor exceptions in audit committees (medium companies' committee chair compensation was $19,700 versus $10,000 for members (49%); and large companies' committee chair compensation was $21,000 versus $11,500 for members (46%). See note 8 above.

Chapter 6: Improving the Board through Director Education

1 The Institute of Corporate Directors in Canada (http://www.icd.ca/) includes director competencies as part of its program for director education and certification. NACD's education and certificate programs are currently focused on knowledge, but may expand into competencies. https://secure.nacdonline.org/source/meetings/meetingshome.cfm.

2 See, for example, Institutional Shareholder Services Corporate Governance Quotient (CGQ) Domestic Rating Criteria, http://issproxy.com/institutional/analytics/uscgqcriteria.jsp.

3 *Report of the NACD Blue Ribbon Commission on Director Liability: Myths, Realities, and Prevention.* (Washington, D.C.: NACD, 2005), page 2.

4 Source: General Motors website at http://www.gm.com/corporate/investor_information/corp_gov/guidelines2.jsp#5.

5 For a discussion of fiduciary duties and the business judgment rule, see Chapter 1 of the *Report of the NACD Blue Ribbon Com-*

mission on Director Liability: Myths, Realities, and Prevention (Washington, D.C.: NACD, 2005).

6 *Ibid.*

7 The NYSE requires financial literacy of all members of the audit committees on the boards of NYSE-listed companies. It is up to each board to define financial literacy. If members are not financially literate at the time of their appointment, they must become so within a reasonable period of time after joining the board. NASDAQ and AMEX rules provide that all audit committee members must be able to read and understand financial statements, including the balance sheet, income statement, and cash flow statement, at the time of appointment.

8 *Report of the NACD Blue Ribbon Commission on Director Professionalism* (Washington, D.C.: NACD, 1996/2001/2005).

Appendices

Appendix A
Sample Governance Committee Charter

Purpose

The Nominating and Governance Committee is appointed by the Board to:

a. Identify individuals qualified to become Board members, consistent with criteria approved by the Board;
b. Recommend that the Board select director nominees for the annual meeting of shareholders;
c. Develop and recommend to the Board a set of corporate governance principles applicable to the Company;
d. Oversee the evaluation of the Board and management; and
e. Play a leadership role in the Company's corporate governance.

Authority

The Nominating and Governance Committee has authority to take appropriate actions necessary to discharge its responsibilities. Such authority includes but is not limited to the power to:

a. Retain outside counsel, accountants, outside advisors, consultants, or others to assist in the conduct of an investigation or as it determines appropriate to advise or assist in the performance of its functions. The Committee shall have sole authority to retain and terminate any search firm to be used to identify director candidates, including sole authority to approve the search firm's fees and other retention terms.
b. Seek any information it requires from employees or external parties. Employees and external parties will be directed to cooperate and comply with the committee's requests.
c. Meet with the senior internal auditor, company officers, external auditors, or outside counsel, as necessary.

Composition

The Nominating and Governance Committee shall have at least three members, each of whom shall meet the independence requirements of the New York Stock Exchange. The Board, after due consideration of the recommendation of the Nominating and Governance Committee, shall appoint the members of the Committee. The chair of the Committee shall be elected by the independent directors of the Board.

Meetings

The Nominating and Governance Committee shall meet as often as may be deemed necessary or appropriate in its judgment, either in person or telephonically, and at such times and places as the Committee shall determine. The Committee shall make regular reports to the Board with respect to its activities.

Responsibilities

Among its specific responsibilities, the Nominating and Governance Committee shall:

1. Establish criteria and qualifications for Board membership, including standards for assessing independence. These criteria and qualifications shall include, among other things:
   a. The highest ethical standards and integrity;
   b. A willingness to act on and be accountable for Board decisions;
   c. An ability to provide wise, informed, and thoughtful counsel to top management on a range of issues;
   d. A history of achievement that reflects superior standards for the director candidate and others;
   e. Loyalty and commitment to driving the success of the Company;
   f. An ability to take tough positions while at the same

time working as a team player; and

g. A background that provides a portfolio of experience and knowledge commensurate with the Company's needs.

2. Identify and consider candidates, including those recommended by shareholders and others, to fill positions on the Board, and assess the contributions and independence of incumbent directors in determining whether to recommend them for reelection to the Board.
3. Recommend to the Board candidates for election or reelection at each annual meeting of shareholders.
4. Recommend to the Board candidates for appointment to the Compensation and Audit Committees and their committee chairs and consider periodic rotation of committee members. The full Board shall select candidates for appointment to the Nominating and Governance Committee.
5. Selecting, monitoring, evaluating, compensating, and if necessary replacing the Senior Vice President—Corporate Governance.
6. Annually review the Company's corporate governance processes, and its governance principles, including such issues as the Board's organization, membership terms, and the structure and frequency of Board meetings, and recommend appropriate changes to the Board.
7. Consider questions of possible conflicts of interest of Board members and senior executives, in collaboration with the Audit Committee, and initiate appropriate action to address any such conflicts.
8. Establish, in collaboration with the Compensation Committee, compensation for directors.
9. Together with the Compensation Committee, review annually with the Chairman/CEO the job performance of the Company's senior executives.
10. Review periodically with the Chairman/CEO and the Board, the succession plans relating to positions held by senior executives, and make recommendations to the Board regarding the selections of individuals to fill these positions.
11. Oversee the orientation of new directors and continuing education of directors.
12. Monitor the functions of the Board and its committees, as set forth in their respective charters, and coordinate and oversee annual self-assessments of the Board's and each committee of the Board's performance and procedures. In particular, the self-assessment will solicit feedback from the directors about:
    a. Overall effectiveness
    b. Composition and structure
    c. Culture
    d. Focus
    e. Information and resources
    f. Process

    The Lead Director, in consultation with all other Board members, will conduct an assessment of individual Board members on an annual basis. Feedback from this process will be provided to board members, as appropriate.
13. Assess annually the Nominating and Governance Committee's and individual member's performance of the duties specified in this Charter and report its findings to the Board.
14. Oversee the company's Environmental, Health, & Safety management program.

Appendix B
Master Calendar For Board and Committee Meetings

	Winter	Spring	Summer	Fall
Approval of Minutes	X	X	X	X
Governance Committee, Chair reporting				
Committee Meets Prior to Board Meeting	X	X	X	X
Report to full Board	X	X	X	X
Election of New Directors		(AS NOMINATED)		
Orientation of New Directors		(AS NOMINATED)		
Election of Officers	X			
Board Evaluation	X			
Strategy Update, CEO reporting	X	X	X	X
Audit & Finance Committee, Chair reporting				
Committee Meets Prior to Board Meeting		X		X
Selection of Auditor		(AS NEEDED)		
Report on Annual Audit	X			
Approval of Annual Budget		X		
Finance & Investment Report	X	X	X	X
Compensation Committee, Chair reporting				
Committee Meets Prior to Board Meeting	X	X		
Report to full Board	X	X		
Future Board Meeting Scheduling	X			
Business from the Floor	X	X	X	X
Executive Session	X	X	X	X

Appendix C

Relationship of the Leader of the Independent Directors and the CEO

Areas of Responsibility	CHAIR/CEO MODEL		NON-EXECUTIVE CHAIR MODEL
	Chair/CEO Role	**Lead Director Role**	**Non-Executive Chair Role**
Full Board Meetings	• Has the authority to call meetings of the board of directors. • Chairs meetings of the board of directors and the annual meeting of shareholders.	• Participates in board meetings like every other director. • Acts as intermediary—at times, the chair may refer to the lead director for guidance or to have something taken up in executive session. • Suggests calling full board meetings to the chair when appropriate.	• Has the authority to call meetings of the board of directors. • Chairs meetings of the board of directors and the annual meeting of shareholders (although in some cases the CEO chairs in the presence of the non-executive chair).
Executive Sessions	• Receives feedback from the executive sessions.	• Has the authority to call meetings of the independent directors. • Sets the agenda for and leads executive sessions of the independent directors. • Briefs the CEO on issues arising in the executive sessions.	• Has the authority to call meetings of the independent directors. • Sets the agenda for and leads executive sessions of the independent directors. • Briefs the CEO on issues arising in the executive sessions.
Board Agendas and Information	• Takes primary responsibility for shaping board agendas, consulting with the lead director to ensure that board agendas and information provide the board with what is needed to fulfill its primary responsibilities.	• Collaborates with the chair/CEO to set the board agenda and board information. • Seeks agenda input from other directors.	• Takes primary responsibility for shaping board agendas in collaboration with the CEO, consults with all directors to ensure that board agendas and information provide the board with what is needed to fulfill its primary responsibilities.

Chart continued:

Areas of Responsibility	CHAIR/CEO MODEL		NON-EXECUTIVE CHAIR MODEL
	Chair/CEO Role	Lead Director Role	Non-Executive Chair Role
Board Communications	• Communicates with all directors on key issues and concerns outside of board meetings.	• Facilitates discussion among the independent directors on key issues and concerns outside of board meetings. • Serves as a non-exclusive conduit (to the CEO) of views, concerns, and issues of the independent directors.	• Facilitates discussion among the independent directors on key issues and concerns outside of board meetings. • Serves as a non-exclusive conduit (to the CEO) of views, concerns, and issues of the independent directors.
External Stakeholders	• Represents the organizationto/ interacts with external stakeholders and employees.	• Typically has no role in representing the organization to external stakeholders. Some boards, however, occasionally ask their lead director to participate in meetings with key institutional investors.	• Can represent the organization to/interact with external stakeholders and employees at the discretion of the board of directors.
Company Operations	• Leads company operations. • Officers and employees report to him or her.	• Has no role in company operations. • Officers and employees report to CEO, not to him or her.	• Has no role in company operations. • Officers and employees report to CEO, not to him or her.

Appendix D
Sample Corporate Governance Guidelines

AETNA INC.

Role of the Board of Directors

Management is responsible for the day-to-day business operations of Aetna Inc. (the "Company"). The Board of Directors (the "Board") oversees and guides the Company's management and its business. The basic responsibility of the Board is to exercise its business judgment to act in what it reasonably believes to be in the best interests of the Company and its shareholders. Within this framework, the Board also considers the Company's ethical behavior and may consider the interests of other constituents, including the Company's customers, employees and the communities in which it functions.

In discharging their obligations, Directors are entitled to rely on the honesty and integrity of the Company's executives, and its outside advisors and auditors. The Directors also shall be entitled to have the Company purchase reasonable directors' and officers' liability insurance on their behalf, to the benefits of indemnification to the fullest extent permitted by law and the Company's Articles of Incorporation and By-Laws, and to exculpation as provided by applicable state law and the Company's Articles of Incorporation.

The Board provides oversight with respect to the strategic direction and key policies of the Company. It approves major initiatives, advises on key financial and business objectives, and monitors progress with respect to these matters.

The Board, directly and through its Audit Committee, provides oversight of the integrity of the financial statements of the Company; the independent accountants' qualifications and independence; the performance of the Company's internal audit function and independent accountants; and the compliance by the Company with legal and regulatory requirements.

The Board selects and annually evaluates the performance of the Chief Executive Officer. Directly and through its Committee on Compensation and Organization (the "Compensation Committee "), the Board also collaborates with the Chief Executive Officer in the selection of senior management. The Compensation Committee, on behalf of the Board, evaluates and determines the compensation of the Company's Chief Executive Officer and its other executive officers; oversees compensation and benefits plans, policies and programs of the Company; administers the equity-based incentive compensation plans of the Company; and considers from time to time and, when appropriate, makes recommendations to the Board as to the development and succession plans for the senior management of the Company.

The Compensation Committee and the Board meet annually in full executive session, without management, to assess the performance of the Chief Executive Officer and consider the Chief Executive Officer's compensation.

The Company's By-Laws provide that the Chairman shall be the Chief Executive Officer, unless the Board vests this position in another officer. The Board may determine to separate these positions based on what is deemed to be in the Company's best interest at any given point in time.

A Presiding Director is appointed by, and from, the independent Directors and serves for a period of time which enables the Presiding Director to perform his or her functions with continuity. Generally speaking, the Presiding Director is responsible for coordinating the activities of the independent Directors. Among other things, the Presiding Director sets the agenda for and leads the nonmanagement and independent Director sessions held by the Board regularly, and briefs the Chairman and Chief Executive Officer on any issues arising out of these sessions. The Presiding Director also acts as the principal liaison to the Chairman and Chief Executive Officer for the views, and any concerns and issues, expressed by the independent Directors, though all Directors continue to interact one-on-one with the Chairman and Chief Executive Officer, as needed and as appropriate. The Chairman and Chief Executive Officer consults with the Presiding Director for input in setting the agenda for Board meetings and the Board meeting schedule. The Presiding Director consults with the other Directors and advises the Chairman about the quality, quantity and timeliness of Board information and the Board's decision-making processes.

Composition of the Board and Selection of Directors

The size and composition of the Board should be appropriate for effective deliberation of issues relevant to the Company's businesses and related interests. A substantial majority of the members of the Board shall be, in the business judgment of the Board, "independent " under the rules of the New York Stock Exchange, Inc.

The credentials of prospective director candidates are reviewed by the Nominating and Corporate Governance Committee (the "Nominating Committee "). Nominees are selected through a process based on criteria set with the concurrence of the full Board and re-evaluated periodically. The criteria weighed in the Director selection process include: the relevance of the candidate's experience to the business of the Company; enhancing the diversity of the Board; the candidate's independence from conflict or direct economic relationship with the Company; and the ability of the candidate to attend Board meetings regularly and devote an appropriate amount of effort in preparation for those meetings. It also is expected that outside Directors nominated by the Board shall be individuals who possess a reputation and hold positions or affiliations befitting a director of a large publicly held company, and are actively engaged in their occupations or professions or are otherwise regularly involved in the business, professional or academic community. Honorary Directors shall not be appointed.

In recommending Director nominees to the Board, the Nominating Committee solicits candidate recommendations from its own members, other Directors and management. It may also engage the services of a search firm to assist it in identifying potential Director nominees. The Nominating Committee will also consider suggestions made by shareholders for Director nominees who meet the established Director criteria.

All new Directors must participate in the Company's Director Orientation Program. This orientation includes presentations by senior management to familiarize new Directors with the Company's strategic plans, its significant financial, accounting and risk management issues, its compliance programs, its code of business conduct and ethics, its principal officers, and its internal and independent auditors. In addition, each Board Committee also provides new Committee members with appropriate background information about the workings of the Committee. The Board encourages formal Board continuing education.

The Nominating Committee annually reviews Director suitability and the continuing composition of the Board; it then recommends Director nominees who are voted on by the full Board. The Board believes that, if this evaluation is well done, it obviates the need for term limits, which could unnecessarily deprive the Company of experienced Directors. All Director nominees stand for election by the shareholders annually.

Any nominee for Director in an uncontested election who receives a greater number of votes "against " his or her election than "for " such election, and who otherwise remains on the Board pursuant to Pennsylvania law, promptly shall submit his or her resignation for consideration by the Nominating Committee. The Nominating Committee shall recommend to the Board the action to be taken with respect to such resignation and the Board shall act with respect to such resignation, in each case within a reasonable period of time. The Company promptly shall disclose to the public each such resignation and decision by the Board.

The Company will hold the vote of each shareholder in confidence from Directors, officers and employees except: (a) as necessary to meet applicable legal requirements (including stock exchange listing requirements) and to assert or defend claims for or against the Company and/or one or more of its consolidated subsidiaries; (b) as necessary to assist in resolving any dispute about the authenticity or accuracy of a proxy card, consent, ballot, authorization or vote; (c) if there is a contested proxy solicitation; (d) if a shareholder makes a written comment on a proxy card or other means of voting or otherwise communicates the shareholder's vote to management; or (e) as necessary to obtain a quorum.

Any significant change in circumstances that may relate to a Director's qualifications as a Director is considered in determining suitability for continued directorship. An analysis of potential conflicts and review by the Nominating Committee and the Board are conducted for proposed additional director affiliations with a for-profit enterprise or for proposed transactions involving the Company (or subsidiary of the Company) in which any Director would have a direct or indirect material interest. Directors shall give the Chairman of the Nominating Committee notice of any such significant change in circumstances (including a change in primary occupation), proposed additional for-profit or charitable director affiliation or proposed transaction involving the Company. Where a Director has a significant change in circumstances, such as a change in his or her primary occupation, the Director also shall offer to submit his or her resignation, which offer may be accepted or rejected by the Board.

As a general matter, a retiring Chief Executive Officer (or other officer Director) will resign from the Board at the time of his/her retirement from the Company. Outside Directors resign no later than the Annual Shareholders Meeting coincident with or immediately following their 75th birthdays.

Functioning of the Board

The Board sets the annual schedule of Board and Committee meetings. Committee schedules are recommended by each Committee in order to meet the responsibilities of that Committee. It is the policy of the Board that Directors should be present at the Company's Annual Meeting of Shareholders.

Board agendas are generally set by the Chairman, in consultation with the Presiding Director, with ample opportunity for suggestions from other Directors.

The Board is provided, in advance of meetings, with agendas and written background information and data with respect to Board/Committee agenda items, as well as other general information relevant to the Company's businesses. The Board also receives regular updates between Board meetings.

The Chairman of the Company presides at Board meetings. In the event that the Chairman of the Company is unable to attend a meeting of the Board of Directors, the Presiding Director shall chair the meeting. In the event that both the Chairman of the Company and the Presiding Director are unable to attend a meeting of the Board of Directors, the most senior Director (in terms of current consecutive years of Board service) present shall, at the request of the Chairman of this Company or the Corporate Secretary of this Company, chair the meeting. Members of senior management are included in open sessions of Board and Committee meetings, as appropriate. The Board meets regularly in executive session with only Directors present. The nonmanagement Directors of the Company also meet at regularly scheduled executive sessions, without management Directors present. In addition, at least once per year, the Company's independent Directors meet in executive session.

Board members have full access to Company management. In addition, the Board and any of its Committees have the authority to retain counsel and other independent experts or consultants, as they may deem necessary, without consulting or obtaining the approval of any officer of the Company in advance.

The Board conducts a self-evaluation annually to determine whether it and its Committees are functioning effectively. This review is overseen by the Nominating Committee.

As a general matter, the Board believes that management speaks for the Company.

Committees of the Board

Committees support the role of the Board on issues that benefit from consideration by a smaller, more focused subset of Directors. The Board will have at all times an Audit Committee, a Compensation Committee and a Nominating Committee. All of the members of these Committees will, in the business judgment of the Board, be "independent" Directors under the rules of the New York Stock Exchange and meet any other standards of independence required under applicable law. The Board also has established an Investment and Finance Committee to assist the Board in reviewing the Company's investment policies, strategies, transactions and performance, and in overseeing the Company's capital and financial resources, and a Medical Affairs Committee to assist the Board in general oversight of policies and practices that relate to providing members with access to quality health care. The Board also has established an Executive Committee, which may act on behalf of the full Board between regularly scheduled Board meetings, usually when timing is critical. The Board may form other Committees from time to time to deal with special issues. One or more Board members also serve on the Board of the Aetna Foundation to oversee and coordinate the Company's charitable giving programs.

The roles of the Committees are defined by the Company's By-Laws and by Committee charters adopted by the Board.

At least annually, the Nominating Committee, in consultation with the Chairman and the Chief Executive Officer, reviews Committee assignments (members and chairs). In considering a Director for Committee membership, the Committee takes into consideration any factors it deems appropriate, including without limitation, the Director's experience and background, and its relevance to the goals and responsibilities of the Committee and the Director's Committee preferences. The Committee then makes Committee assignment recommendations on which the full Board votes. It is the sense of the Board that Committee members and Committee chairs should be rotated, where appropriate and practical, while providing overlap to prevent loss of expertise and experience and maintain continuity. Generally, consideration is given to rotating a Committee chair after approximately five years of service as chair. The Board strives to select new Committee chairs from Directors who have prior experience on the relevant Committee.

Committee agendas are set by the respective Committee chairs in consultation with management and other Committee members. Committee chairs report on each Committee meeting at the Board meeting following the Committee meeting. Minutes of Committee meetings also are provided to each Director. Each Committee chairman convenes, as appropriate, executive sessions of outside Directors of the Committee to discuss its operations and other related matters.

In the absence of a Committee chair, the most senior Committee member (in terms of Committee service) chairs the Committee meeting.

Compensation of Directors

At least annually, the Nominating Committee reviews competitive compensation survey information, and considers the appropriateness of the form and amount of Director compensation with a view toward attracting and retaining qualified Directors.

The Nominating Committee, with the concurrence of the full Board, has directed that a significant portion of Director compensation be delivered in stock-based forms. In addition, a deferred compensation plan also allows individual Directors voluntarily to defer cash compensation into deferred stock units. The Board of Directors also has adopted Stock Ownership Guidelines, whereby within five years of appointment to the Board, each Director should own stock of the Company having a value equal to $400,000. It is understood that if Directors temporarily do not meet this guideline because there has been a significant drop in the price of the Company's stock, they would have a reasonable period of time to acquire additional shares of stock necessary to meet the guidelines.

Conduct and Ethics Standards for Directors

Directors are subject to applicable provisions of the Company's Code of Conduct. Among other things, Directors must conduct themselves in a manner that avoids actual or apparent conflicts of interest and that protects the Company's business reputation. A conflict of interest occurs when a Director's private interest interferes in any way—or even appears to interfere—with the interest of the Company. Except as authorized by the Board of Directors, no outside Director shall have a direct economic relationship with the Company. Company loans to, or guarantees of obligations of, Directors and their family members are prohibited.

Directors owe a duty to the Company to advance its legitimate interests when the opportunity to do so arises. Accordingly, Directors are prohibited from taking for themselves personally business opportunities that are discovered through the use of Company property, information or position.

Directors, in the course of their Company duties, must comply fully with all federal and state laws applicable to the Company's businesses, and with applicable Company policies (including policies relating to use of confidential information and insider trading).

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Appendix E
Sample Policy Regarding Nominations of Directors

The Nominating and Corporate Governance Committee (the "Committee") has adopted the following policy (the "Director Nomination Policy") to assist it in fulfilling its duties and responsibilities as provided in its charter (the "Charter"). This Director Nomination Policy may be amended and/or restated from time to time by the Committee in accordance with the Charter and as provided herein.

1. Recommended Candidates. The Committee shall consider any and all candidates recommended as nominees for directors to the Committee by any directors, officers, shareholders of the Company, third party search firms and other sources. Under the terms of the Company's By-Laws, the Committee will consider director nominations from shareholders of record who provide timely written notice along with prescribed information to the Secretary of the Company. To be timely, the notice must be received by the Secretary at the principal executive offices of the Company not later than 60 or earlier than 90 days prior to the anniversary of the previous year's annual meeting, except in the case of candidates recommended by shareholders of more than 5% of the Company's Common Stock who may also submit nominations in accordance with the procedures in Section 2 under "5% Shareholder Recommendations" and except as otherwise provided in the Company's By-Laws. The shareholder's notice must set forth (1) all information relating to such director nominee that is required to be disclosed under the federal securities laws in solicitation of proxies for election of directors in an election contest, including the person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; (2) the name and address of the shareholder and any beneficial owner giving the notice as they appear on the Company's books together with the number of shares of the Company's Common Stock which are owned beneficially and of record by the shareholder and any beneficial owner; and (3) a signed statement by the nominee agreeing that, if elected, such nominee will (a) represent all Company shareholders in accordance with applicable laws and the Company's By-Laws and (b) comply with the Company's Corporate Compliance Policy and this Director Nomination Policy.

2. 5% Shareholder Recommendations. For purposes of facilitating disclosure required in the Proxy Statement, the Committee and the Corporate Secretary shall identify any candidates recommended by shareholders owning more than 5% of the Company's Common Stock, and identify the shareholder making such recommendation, as provided in and to the extent required by the federal securities laws. In addition to the procedures for shareholders to recommend nominees described in Section 1 above, shareholders or a group of shareholders who have owned more than 5% of the Company's Common Stock for at least one year as of the date the recommendation was made, may recommend nominees for director to the Committee provided that (1) written notice from the shareholder(s) must be received by the Secretary of the Company at the principal executive offices of the Company not later than 120 days prior to the anniversary of the date the Company's proxy statement was released to shareholders in connection with the previous year's annual meeting, except as otherwise provided in the Company's By-Laws; (2) such notice must contain the name and address of the shareholder(s) and any beneficial owner(s) giving the notice as they appear on the Company's books, together with evidence regarding the number of shares of the Company's Common Stock together with the holding period and the written consent of the recommended candidate and the shareholder(s) to being identified in the Company's proxy statement; (3)

such notice must contain all information relating to such director nominee that is required to be disclosed under federal securities laws in solicitation of proxies for election of directors in an election contest; and (4) such notice must contain a signed statement by the nominee agreeing that, if elected, such nominee will (a) represent all Company shareholders in accordance with applicable laws and the Company's By-Laws and (b) comply with the Company's Corporate Compliance Policy and this Director Nomination Policy.

3. Desired Qualifications, Qualities and Skills. The Committee shall endeavor to find individuals of high integrity who have a solid record of accomplishment in their chosen fields and who possess the qualifications, qualities and skills to effectively represent the best interests of all shareholders. Candidates will be selected for their ability to exercise good judgment, and to provide practical insights and diverse perspectives.

The Committee considers the following qualifications at a minimum to be required of any Board members in recommending to the Board of Directors potential new Board members, or the continued service of existing members:

- the highest professional and personal ethics;
- broad experience in business, government, education or technology;
- ability to provide insights and practical wisdom based on their experience and expertise;
- commitment to enhancing shareholder value;
- sufficient time to effectively carry out their duties; their service on other boards of public companies should be limited to a reasonable number;
- compliance with legal and regulatory requirements;
- ability to develop a good working relationship with other Board members and contribute to the Board's working relationship with senior management of the Company; and
- independence; a majority of the Board shall consist of independent directors, as defined in this Director Nomination Policy.

Other than the foregoing, there are no stated minimum criteria for director nominees, although the Committee may also consider such other factors as it may deem are in the best interests of the Company and its shareholders. The Committee does, however, believe it appropriate for at least one member of the Board to meet the criteria for an "audit committee financial expert" as defined by Securities and Exchange Commission rules.

4. Independence. The Committee believes and it is the policy of the Company that a majority of the members of the Board meet the definition of "independent director" set forth in this Director Nomination Policy. The Committee shall annually assess each nominee for director by reviewing any potential conflicts of interest and outside affiliations, based on the criteria for independence set out below.

An independent director is one who:

(1) has no material relationship with the Company, either directly or as a partner, shareholder or officer of an organization that has a relationship with the Company;

(2) is not an employee of the Company and no member of his or her immediate family is an executive officer of the Company;

(3) has not been employed by the Company and no member of his or her immediate family has been an executive officer of the Company during the past three years;

(4) has not received and no member of his or her immediate family has received more than $100,000 per year in direct compensation from the Company in any capacity other than as a director or as a pension for prior service during the past three years;

(5) (A) is not and no member of his or her imme-

diate family is a current partner of a firm that is the Company's internal or external auditor; (B) is not a current employee of the Company's internal or external auditor; (C) does not have an immediate family member who is a current employee of the Company's internal or external auditor and who participates in that firm's audit, assurance or tax compliance (but not tax planning) practice; and (D) within the last three years was not and no member of his or her immediate family was (and no longer is), a partner or employee of the Company's internal or external auditor and personally worked on the Company's audit within that time;

(6) is not and no member of his or her immediate family is currently, and for the past three years has not been, and no member of his or her immediate family has been, part of an interlocking directorate in which an executive officer of the Company serves on the compensation committee of another company that employs the director or an immediate family member of the director;

(7) is not an executive officer or an employee, and no member of his or her immediate family is an executive officer, of another company that makes payments to, or receives payments from, the Company for property or services in an amount which, in any single year, exceeds the greater of $1 million, or 2% of such other company's consolidated revenues during any of the past three years;

(8) is free of any relationships with the Company that may impair, or appear to impair, his or her ability to make independent judgments; and

(9) is not and no member of his or her immediate family is employed as an executive officer of a charitable organization that receives contributions from the Company or a Company charitable trust, in an amount which exceeds the greater of $1 million or 2% of such charitable organization's total annual receipts.

This policy may be modified temporarily if, due to unforeseen circumstances, strict adherence would be detrimental to the Board's performance.

For purposes of determining a "material relationship," the Committee shall utilize the following standards:

1. Any payments by the Company to a director's primary business affiliation or the primary business affiliation of an immediate family member of a director for goods or services, or other contractual arrangements, must be made in the ordinary course of business and on substantially the same terms as those prevailing at the time for comparable transactions with non-affiliated persons.
2. The aggregate amount of such payments must not exceed 2% of the Company's consolidated gross revenues; provided, however, there may be excluded from this 2% standard payments arising from (a) competitive bids which determined the rates or charges for the services and (b) transactions involving services at rates or charges fixed by law or governmental authority.

For purposes of these independence standards, (i) immediate family members of a director include the director's spouse, parents, stepparents, children, stepchildren, siblings, mother- and father-in-law, sons- and daughters-in-law, and brothers- and sisters-in-law and anyone (other than domestic employees) who shares the director's home and (ii) the term "primary business affiliation" means an entity of which the director is a principal/executive officer or in which the director holds at least a 5% equity interest.

5. Nominee Evaluation Process. The Committee will consider as a candidate any director of the Company who has indicated to the Committee that he or she is willing to stand for re-election as well as any other person who is recommended by any shareholders of the Company in accordance with the procedures described under "Recommended Candidates" in Section 1 and under "5% Shareholder Recommendations" in Section 2. The Committee may also undertake its own search process for candidates and may retain the services of professional search firms or other third parties to assist in identifying and evaluating potential nominees and, if fees are paid to such persons in any year, such fees shall be disclosed in the next annual Proxy Statement relating to such year. The Committee may use any process it deems appropriate for the purpose of evaluating candidates which is consistent with the policies set forth in the Charter, Corporate Governance Guidelines and this Director Nomination Policy, which process may include, without limitation, personal interviews, background checks, written submissions by the candidates and third party references. Although the Committee may seek candidates that have different qualities and experiences at different times in order to maximize the aggregate experience, qualities and strengths of the Board members, nominees for each election or appointment of directors shall be evaluated using a substantially similar process and under no circumstances shall the Committee evaluate nominees recommended by a shareholder of the Company pursuant to a process substantially different than that used for other nominees for the same election or appointment of directors.

6. Categorize Recommendations. For purposes of facilitating disclosure required in the Proxy Statement, the Committee and the Corporate Secretary shall identify and organize the recommendations for nominees received by the Committee (other than nominees who are executive officers or who are directors standing for re-election) in accordance with one or more of the following categories of persons or entities that recommended that nominee:

(1) a shareholder, a 5% shareholder, independent director, chief executive officer, or other executive officer of the Company;
(2) a third-party search firm used by or on behalf of the Company; and
(3) any other specified source.

7. Voting for Directors. Each director and each nominee for election as director shall agree, by serving as a director or by accepting nomination for election as a director, that if while serving as a director such director is a nominee for re-election as a director at an annual meeting of the shareholders and fails to obtain the necessary shareholder vote, as provided in the Company's By-Laws, to be re-elected as a director at the annual meeting, he or she shall tender his or her resignation as a director for consideration by the Committee. The Committee shall evaluate the best interests of the Company and its shareholders and shall recommend to the Board the action to be taken with respect to such tendered resignation.

8. Material Changes to Nomination Procedures. For proposes of facilitating disclosure required in Form 10-K and Form 10-Q, the Committee and the Corporate Secretary shall identify any material changes to the procedures for shareholder nominations of directors for the reporting period in which such material changes occur.

9. Posting of Policy. This Director Nomination Policy shall be posted to the Company's website in accordance with the Company's Corporate Governance Guidelines.

10. Amendments to This Policy. Any amendments to this Director Nomination Policy must be approved by the Committee and ratified by the Board.

11. Applicability to Registered Companies. This Director Nomination Policy shall apply to all Company subsidiaries which are registered companies under the Securities Exchange Act of 1934 and that are required to file a proxy or information statement pursuant thereto, provided that the independence requirements contained herein shall not apply to such registered companies which constitute “controlled companies” within the meaning of NYSE listing requirements pursuant to an election by each controlled company, as permitted under NYSE listing requirements.

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Appendix F
Sample Board Expertise Matrix

HEALTHCARE BOARD CANDIDATE CRITERIA

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Personal Traits/Characteristics

High ethical standards and integrity. Willing to act on and be accountable for Board decisions. Ability to provide wise, thoughtful counsel on a range of issues. Have a history of achievements that reflect high standards for themselves and others. Will be loyal and committed to driving success of the company. Able to take tough positions while being a team player.

General Business Traits

Track record of driving growth for complex, high performance businesses. Global expertise/knowledge of key international markets. Enriches the diversity of the Board. Commitment to active engagement in a new board role; availability of time to serve.

Independence Standards

To maintain its objective oversight of management, the board must consist of a substantial majority of independent directors and meet stringent definitions of independence. Independent directors:

- Include no former officer or employee of the Company or its subsidiaries or affiliates, or has served in that capacity within the last five years;
- Have no current or prior material relationships with the Company aside from their directorship that could affect their judgment;
- Have not worked for, consulted with, been retained by, or received anything of substantial value from the Company aside from his or her compensation as directors;
- Have no immediate family member who is an officer of the Company or its subsidiaries or has any current or past material relationship with the Company;
- Do not work for, consult with, or are retained by another publicly traded company on whose Board of Directors the Company's CEO or other senior management serves;
- Do not serve as an executive officer of any entity which the Company's annual sales to or purchases from exceeded one percent of either entity's annual revenues for the last fiscal year.
- Do not serve on either the board of directors or the compensation committee of any corporation that employs either a nominee for director or a member of the immediate family of any nominee for director; and
- Do not serve as a director, trustee, executive officer or similar position of a charitable or non-profit organization to which the Company or its subsidiaries made charitable contributions or payments in excess of one percent of the organization's charitable receipts or the Company's charitable donations during the last fiscal year.

Critical Criteria Explanations

Senior Leadership Experience: Outstanding track record as a business leader, preferably as CEO or President. An independent thinker with appropriate stature and style. Experienced at dealing with multiple shareholders.

Business Development/M&A experience: Experience with spin-offs or repositioning businesses for sustained growth and long-term value creation. Track record of driving growth for complex, high performance businesses.

Financial Expertise: Education and experience as, or experience actively supervising, a: principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions. For further explanation, please see footnote 4 in the Audit Committee section below.

Public Board Experience: Track record of business leadership and demonstrable grasp of modern board practice and principles. Need the ability to guide, facilitate and empower the debate of critical issues, leveraging all board members' skills and knowledge to achieve a consensus and deliver results.

Diversity: Diversity in perspective, experience base, geography, age and background. Diverse perspectives are critical to be creative, innovate, problem solve and grow effectively as an organization. Candidates should be a representative of customers and employees that we have now and those we are seeking in the future.

Independence: To maintain its objective oversight of management, the board must consist of a substantial majority of independent directors and meet stringent definitions of independence. Please see previous page for detailed definition of independence.

Important Criteria Explanations

Industry Experience: Expertise in key businesses (medical devices, healthcare provider systems, pharmaceuticals) and proven knowledge of key customers and risks associated with the business.

Operating/Manufacturing Experience: Operating expertise and general management strength; commitment to operational excellence.

Global Experience: Global expertise/knowledge of key international markets (with emphasis on Asia).

Information Technology Experience: Solid understanding of information technology systems and developments, either through academia or industry experience.

Brand Marketing Experience: Experience with business-to-business brand marketing in a global organization.

Governmental Experience: Experience as, or working closely with, government officials at a local, state or federal level.

Regulatory Experience: Knowledge of regulatory issues, FDA, government relations and public policy.

Healthcare Board Candidate Criteria[1]: CRITICAL CRITERIA						
	Senior Leadership Exp. (CEO/Pres.)	**Bus Dev/ M&A Exp.**	**Financial Expertise** (CFO)	**Public Board Exp.**	**Diversity**	**Independence**
Board Candidate 1						
Board Candidate 2						
Board Candidate 3						
Board Candidate 4						
Board Candidate 5						
Board Candidate 6						
Board Candidate 7						
Board Candidate 8						
Board Candidate 9						
Board Candidate 10						
Board Candidate 11						

1 Board Criteria matrix was developed in a three part process. (1) Review of process and matrix during the development of the Tyco Board; (2) Use of outside literature including David A. Nadler, Beverly Behan, Mark Nadler and Jay Lorsch, *Building Better Boards*, Jossey-Bass, January 2006; and (3) Discussion with and feedback from the new companies' CEOs.

Healthcare Board Candidate Criteria[1]: OTHER IMPORTANT CRITERIA								
	Industry Exp. (Medical Devices)	**Industry Exp.** (Provider Systems or other)	**Oper./ MfgExp.**	**Global Exp.**	**IT/Tech Exp.** (Acad./ Industry)	**Brand Mrktg Exp.**	**Govt Exp.** (State or fed)	**Reg. Exp.** (Ex. FDA official)
Board Candidate 1								
Board Candidate 2								
Board Candidate 3								
Board Candidate 4								
Board Candidate 5								
Board Candidate 6								
Board Candidate 7								
Board Candidate 8								
Board Candidate 9								
Board Candidate 10								
Board Candidate 11								

1 Board Criteria matrix was developed in a three part process. (1) Review of process and matrix during the development of the Tyco Board; (2) Use of outside literature including Beverly Behan's book, *Building Better Boards*, published in January 2006; and (3) Discussion with and feedback from the new companies' CEOs.

Healthcare Board Candidate Criteria: Audit Committee							
	Independence[2]	**Financial Literacy**[3]	**Financial Expertise**[4] (CFO)	**Audit Committee Experience**	**Global Experience**	**Industry Experience** (Med. Devices, Provider Systems, etc)	**Other** (Govt, CPA, etc)
Board Candidate A							
Board Candidate B							
Board Candidate C							
Board Candidate D							
Board Candidate E							
Board Candidate F							

2 To serve on the Audit Committee, there are additional independence criteria a member must meet. (A) Candidate does not accept, directly or indirectly, any consulting, advisory, or other compensatory fee from Tyco or **[insert new business name]** or any subsidiary thereof including indirect compensation (compensation paid by **[insert new business name]** to a consulting firm, investment bank, financial advisory firm, accounting firm or law firm with which the director serves as an executive officer, partner or similar position). (B) Candidate is not an affiliated person of Tyco, **[insert new business name]** or any subsidiary thereof.

3 NYSE and NASD rules (SEC release no. 34-41982 and SR-NYSE-99-39) provide that companies with a stated market capitalization must have audit committees consisting of at least three directors who are financially literate or who become financially literate within a reasonable time after their appointment.

4 The same rules as above require at least 1 of the members to be a "financial expert". To meet this requirement, the candidate must have acquired such attributes through any one or more of the following: (i) Education and experience as a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions; (ii) Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions; (iii) Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluating financial statements; or (iv) Other relevant experience.

Healthcare Board Candidate Criteria: Compensation Committee						
	Senior Leadership Experience (CEO/Pres.)	**Compensation Committee Experience**	**Human Resources/ Comp/ Benefits Experience**	**Global Experience**	**Industry Experience** (Med. Devices, Provider Systems, etc)	**Other** (Govt, CPA, etc)
Board Candidate A						
Board Candidate B						
Board Candidate C						
Board Candidate D						
Board Candidate E						

Nominating & Governance Committee					
	Public Board Experience	**N&G Committee Experience**	**Business Management (CEO/Pres.)**	**Industry Experience** (Med. Devices, Provider Systems, etc)	**Other** (Govt, CPA, etc)
Board Candidate A					
Board Candidate B					
Board Candidate C					
Board Candidate D					
Board Candidate E					

Director Independence Matrix[5]: Summary of Results								
	Board Member	**Board Member**	**Board Member**	**Board Member**	**Board Member**	**Board Member**	**Board Member**	**Board Member**
Independent Board Members								
Eligible for Audit Committee (Independence Standards)								
Has Requisite Financial Literacy								
Eligible to be an Audit Committee Financial Expert								
Eligible for Compensation Committee								
Eligible for Nominating & Governance Committee								

5 As described in the NYSE guidelines.

Appendix G
Sample Board & Board Committee Self-Evaluation Form

Source: Weil, Gotshal & Manges, LLC, 2007. Reprinted with permission.

The following sample Board and Board Committee Self-Evaluation Form is intended to comport with corporate governance listing standards of the New York Stock Exchange and generally accepted practices for boards of directors of publicly-traded U.S. companies.

The New York Stock Exchange's listing standards require that a listed company have a set of corporate governance guidelines and principles that address, among other things, board evaluation. The New York Stock Exchange's listing standards also require that the key committee charters provide for annual evaluations of committee operations. The Nasdaq listing standards do not require board or committee evaluations, although many Nasdaq companies perform such evaluations as a "good governance" practice. Note that PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements ("AS2") (available at http://www.pcaobus.org/Rules/Rules_of_the_Board/Auditing_Standard_2.pdf) now requires – and, if adopted, the PCAOB's proposed auditing standard AS2 which would supersede current AS2, will require – the independent auditor to evaluate – as part of its broader evaluation of the control environment – the effectiveness of the audit committee's oversight of the financial reporting process and related internal controls. As part of their own evaluation, many independent auditors are inquiring into whether the board has evaluated the audit committee and found it to be effective. Therefore, at minimum, Nasdaq companies should consider evaluating the effectiveness of the audit committee, and all public company boards should pay special attention to such evaluation.

Board and Board Committee Self-Evaluation Form

This form is intended for the communication of information to legal counsel, to enable counsel to advise the Board in the Board's continuous efforts to improve corporate governance.

Please respond to the following questions, on a scale of:

* 1 (room for improvement), to
* 5 (area of considerable strength).

Please provide written comments throughout, including suggestions for improving board and committee structure and process. Your individual responses will be kept confidential, and will be reported back to the Board only in a composite that provides anonymity.

I. THE BOARD OF DIRECTORS						
A. Board Size and Composition						
1	Is the Board the right size? (If not, what size should it be?) Comments:	1	2	3	4	5
2	Does the Board's composition reflect an appropriate proportion of independent, non-executive and executive directors? (If not, how should the proportions be adjusted?) Comments:	1	2	3	4	5
3	Does the Board's composition reflect an appropriate mix of skills, experience, backgrounds, and diversity in relation to the needs of the Company? (What characteristics should be represented more/less?) Comments:	1	2	3	4	5
4	Does the Board make appropriate use of the skills and experience of its members? Comments:	1	2	3	4	5
5	Is each director contributing to the work of the Board in an effective manner? Comments:	1	2	3	4	5

I. THE BOARD OF DIRECTORS						
B. Board Information & Agenda						
6	Is the Board actively engaged with management in identifying, prioritizing and scheduling issues for Board review and discussion? Comments:	1	2	3	4	5
7	Is the Board actively engaged in identifying and communicating to management the Board's information needs, including information about the competitive environment, risk identification and assessment, and performance benchmarks? Comments:	1	2	3	4	5
8	Do Board members receive timely and accurate minutes, advance written agendas and meeting notices? Comments:	1	2	3	4	5
9	Do Board members receive clear, concise and relevant background materials to prepare in advance for meetings? Comments:	1	2	3	4	5
10	Do Board members stay abreast of issues and trends affecting the company, and use this information to assess and guide the company's performance both year-to-year and in the long term? Comments:	1	2	3	4	5

I. THE BOARD OF DIRECTORS						
B. Board Information & Agenda						
11	Do Board members devote time to learn about the company's business and understand it well enough to provide critical oversight? Comments:	1	2	3	4	5
12	Does the Board regularly monitor company performance with industry comparative data? Comments:	1	2	3	4	5
13	Is the majority of Board meeting time reserved for Board discussion and consideration rather than management presentations? Comments:	1	2	3	4	5
14	Do Board members have sufficient access to officers and other members of the management team outside of Board meetings? Comments:	1	2	3	4	5
15	Are new Board members provided with an appropriate orientation and other relevant information about the company and the Board? Comments:	1	2	3	4	5

I. THE BOARD OF DIRECTORS						
B. Board Information & Agenda						
16	Are directors kept well informed of important company matters between Board meetings? Comments:	1	2	3	4	5
17	Does the Board devote sufficient attention to:	1	2	3	4	5
	(a) the company's financial statements and processes?	1	2	3	4	5
	(b) the company's annual capital and operating budgets and plans?	1	2	3	4	5
	(c) the company's long-term strategic plans and planning process?	1	2	3	4	5
	(d) the company's standards of governance and conduct?	1	2	3	4	5
	(e) international operations and developments?	1	2	3	4	5
	(f) technological developments?	1	2	3	4	5
	(g) legal and regulatory developments and compliance?	1	2	3	4	5
	(h) management development and succession?	1	2	3	4	5
	(i) periodic review of major completed transactions (integration and shareholder value creation)?	1	2	3	4	5
C. Accountability						
18	Has the Board developed with management a common understanding of the company's beliefs, values and philosophy, and is this understanding reflected in the company's mission, its strategic and business plans and key deliberations throughout the year? Comments:	1	2	3	4	5
19	Does the Board regularly monitor performance against the strategic and business plans? Comments:	1	2	3	4	5

I. THE BOARD OF DIRECTORS						
C. Accountability						
20	Does the Board adequately consider shareholder value and the protection of shareholder interests in its decision-making? Comments:	1	2	3	4	5
21	Are Board meetings conducted in a manner that ensures open communication, meaningful participation and timely resolution of issues? Comments:	1	2	3	4	5
22	Does the Board encourage/ensure an open line of communication: (a) Between the Board and senior management? (b) Between Board members? Comments:	1	2	3	4	5
23	Are Board goals, expectations, and concerns openly, honestly and constructively communicated to the CEO? Comments:	1	2	3	4	5
24	Does the Board understand and respect the difference between the Board's role and the CEO/senior management's role? Comments:	1 1 1	2 2 2	3 3 3	4 4 4	5 5 5

I. THE BOARD OF DIRECTORS						
C. Accountability						
25	Is the Board regularly and actively engaged in evaluating the performance of the CEO? Comments:	1	2	3	4	5
26	Does the Board support the CEO/senior management to act realistically, appropriately and responsibly, while holding the CEO/senior management accountable for operating results? Comments:	1	2	3	4	5
D. Standards of Conduct						
27	Are directors prepared for Board meetings? Comments:	1	2	3	4	5
28	Do directors ask appropriate questions of management? Comments:	1	2	3	4	5
29	Do directors and senior management adequately disclose personal interests in matters subject to Board review and abstain from voting where appropriate? Comments:	1	2	3	4	5
30	Does the Board deal appropriately with conflicts of interest? Comments	1	2	3	4	5

I. THE BOARD OF DIRECTORS						
E. Meeting Schedule						
31	Are Board meetings held at an appropriate time of day? Comments:	1	2	3	4	5
32	Is the length of Board meetings appropriate? Comments:	1	2	3	4	5
33	Is the number of Board meetings appropriate? (If not, what number would be optimal?) Comments:	1	2	3	4	5

II. BOARD COMMITTEES						
A. Generally						
34	Does the current committee structure (and committee responsibilities as set forth in charters) contribute to Board efficiency and effectiveness? Comments:	1	2	3	4	5
35	Are the responsibilities of the committees well defined? Comments:	1	2	3	4	5
36	Are all Board members kept well informed of the deliberations of each committee? Comments:	1	2	3	4	5
37	Does the Board rely appropriately on the work and the recommendations of the committees? Comments:	1	2	3	4	5
38	Is the board's method for determining committee membership and leadership appropriate? Comments:	1	2	3	4	5
39	Is the Audit Committee effective in fulfilling its responsibilities? [You may wish to review and consider the questions set forth in Section B, below.] Comments:	1	2	3	4	5

II. BOARD COMMITTEES

A. Generally

40	Is the Compensation Committee effective in fulfilling its responsibilities? [You may wish to review and consider the questions set forth in Section C, below.] Comments:	1	2	3	4	5
41	Is the Nominating & Corporate Governance Committee effective in fulfilling its responsibilities? [You may wish to review and consider the questions set forth in Section D, below.] Comments:	1	2	3	4	5

B. Audit Committee[6]

(To be answered by Audit Committee Members concerning that Committee's performance.)

42	Is the Audit Committee fulfilling the duties set forth in its charter? Comments:	1	2	3	4	5
43	Are Audit Committee meetings efficient and productive? Comments:	1	2	3	4	5
44	Does the Audit Committee hold an adequate number of meetings during the year? Comments:	1	2	3	4	5
45	Is the length of Audit Committee meetings appropriate? Comments:	1	2	3	4	5

II. BOARD COMMITTEES						
B. Audit Committee						
46	Are Audit Committee agendas set and prioritized to assist the Committee to function effectively? Comments:	1	2	3	4	5
47	Do Committee members have adequate input into the preparation of agendas? Comments:	1	2	3	4	5
48	Do Committee members receive adequate background information prior to meetings? Comments:	1	2	3	4	5
49	Is meeting time appropriately allocated between management presentation and Committee discussion, so as to allow adequate opportunity for deliberation? Comments:	1	2	3	4	5
50	Are meetings conducted in a manner and on a schedule that ensures open communication and meaningful participation? Comments:	1	2	3	4	5
51	Does the Committee reach timely resolution of issues? Comments:	1	2	3	4	5

6 See Additional Considerations for Audit Committee Evaluation attached.

II. BOARD COMMITTEES

B. Audit Committee

52	Does the Committee report on its work and recommendations to the Board in a timely and effective manner? Comments:	1	2	3	4	5
53	Is the Committee's leadership effective? Comments:	1	2	3	4	5

C. Compensation Committee

(To be answered by Compensation Committee members concerning that Committee's performance)

54	Is the Compensation Committee fulfilling the duties set forth in its charter? Comments:	1	2	3	4	5
55	Are Compensation Committee meetings efficient and productive? Comments:	1	2	3	4	5
56	Does the Committee hold an adequate number of meetings during the year? Comments:	1	2	3	4	5
57	Is the length of Committee meetings appropriate? Comments:	1	2	3	4	5

II. BOARD COMMITTEES						
C. Compensation Committee						
58	Are Committee agendas set and prioritized to assist the Committee to function effectively? Comments:	1	2	3	4	5
59	Do Committee members have adequate input into the preparation of agendas? Comments:	1	2	3	4	5
60	Do Committee members receive adequate background information prior to meetings? Comments:	1	2	3	4	5
61	Is meeting time appropriately allocated between management presentation and Committee discussion so as to allow adequate opportunity for deliberation? Comments:	1	2	3	4	5
62	Are meetings conducted in a manner and on a schedule that ensures open communication and meaningful participation? Comments:	1	2	3	4	5
63	Does the Committee reach timely resolution of issues? Comments:	1	2	3	4	5

II. BOARD COMMITTEES

C. Compensation Committee

64	Does the Committee report on its work and recommendations to the Board in a timely and effective manner? Comments:	1	2	3	4	5
65	Is the Committee's leadership effective? Comments:	1	2	3	4	5

D. Nominating and Corporate Governance Committee

(To be answered by Nominating and Corporate Governance Committee members concerning that Committee's performance)

66	Is the Nominating and Corporate Governance Committee fulfilling the duties set forth in its charter? Comments:	1	2	3	4	5
67	Are Nominating and Corporate Governance Committee meetings efficient and productive? Comments:	1	2	3	4	5
68	Does the Committee hold an adequate number of meetings during the year? Comments:	1	2	3	4	5
69	Is the length of Committee meetings appropriate? Comments:	1	2	3	4	5

II. BOARD COMMITTEES

D. Nominating and Corporate Governance Committee

70	Are Committee agendas set and prioritized to assist the Committee to function effectively? Comments:	1	2	3	4	5
71	Do Committee members have adequate input into the preparation of agendas? Comments:	1	2	3	4	5
72	Do Committee members receive adequate background information prior to meetings? Comments:	1	2	3	4	5
73	Is meeting time appropriately allocated between management presentation and Committee discussion, so as to allow adequate opportunity for deliberation? Comments:	1	2	3	4	5
74	Are meetings conducted in a manner and on a schedule that ensures open communication and meaningful participation? Comments:	1	2	3	4	5
75	Does the Committee reach timely resolution of issues? Comments:	1	2	3	4	5

II. BOARD COMMITTEES						
D. Nominating and Corporate Governance Committee						
76	Does the Committee report on its work and recommendations to the Board in a timely and effective manner? Comments:	1	2	3	4	5
77	Is the Committee's leadership effective? Comments:	1	2	3	4	5

Additional Considerations for Audit Committee Evaluation[7]

Organization

1. Does the Audit Committee charter clearly set forth the nature and scope of committee responsibilities?
2. Has the charter been approved by the Committee and the full Board?
3. Does the Committee's composition meet all regulatory requirements?
4. Was the Board actively involved in considering Audit Committee composition, including the designation of the "Audit Committee financial expert"?
5. Do all members actively participate and contribute to the work of the Committee in an effective manner?
6. Does the Committee exhibit in its actions independence from management, ethical behavior, and concern for the best interests of shareholders?
7. Do meeting packages include the right information and are they received with enough lead time to provide the basis for meaningful discussion?
8. Are meetings well organized, efficient, and effective? Do they occur often enough and are they of sufficient length to allow discussion of relevant issues consistent with the Committee's responsibilities?
9. Are members open, honest, and effective in their communication with management, internal and external auditors, and each other?
10. Does the Committee have access to appropriate internal and external resources?
11. Do the minutes and reports to the full Board reflect the significant activities, actions, and recommendations of the Committee?
12. Is the Committee Chair's leadership effective?

Audit Committee Agenda Setting and Oversight of the Financial Reporting Process

1. Does the Committee help establish the appropriate "tone at the top," including an insistence on integrity and accuracy in financial reporting?
2. Has the Committee achieved the right balance of providing effective oversight, without infringing on management's responsibility?
3. Has the company devoted appropriate internal (and external) resources to ensuring the adequacy of its financial reporting process?
4. Does the Committee set clear expectations and provide feedback concerning the competency of the company's CFO and senior financial management staff?
5. Do the Committee's agenda and deliberations reflect ongoing and appropriate consideration of the company's financial reporting risks and related internal controls?
6. Is the Committee's agenda-setting process thorough and led by the Committee Chair?
7. Does the Committee engage in meaningful discussion and consideration of the company's external financial reporting (including the annual report, quarterly financial filings, and press releases)?
8. Does the Committee review and provide effective oversight concerning related person transactions, including the disclosure of such transactions in the proxy statement and/or financial reports?
9. Is the Committee actively engaged in providing oversight of "whistleblower" procedures? (What involvement does the Committee have in the "whistleblower" communication process?)

Oversight of Audit Processes

1. Do the Committee's actions demonstrate that it takes direct responsibility for the appointment, compensation, and oversight of the work of the independent auditor?
2. Does the Committee actively consider the audit plan and results of the independent audit?
3. Is the pre-approval process over non-audit services to be provided by the independent auditor effective; is it designed to reinforce the auditor's independence?
4. Is there an effective procedure in place for the evaluation of the independent auditor's qualifications, performance, and independence?
5. Is appropriate consideration given to the management letter and other communications from the independent auditor?
6. Do the internal audit reporting lines and interaction with the Committee foster an environment in which issues that might involve management are likely to be brought to the attention of the Committee? (How does the Committee demonstrate and reinforce its direct responsibility for oversight of the independent auditor?)
7. Does the Committee give appropriate consideration to the internal audit department's plan, resources, and ability?
8. Does the Committee give appropriate consideration to the internal audit department's reports, management's response, and improvement actions?
9. Do the Committee's executive sessions with the internal and independent auditor result in candid discussion of relevant issues?

Continuous Improvement

1. Does the Committee provide effective orientation for new members?
2. Does the Committee provide and encourage ongoing education for members?
3. Is this evaluation process effective?
4. Do any and all matters identified that require follow-through get resolved?

Overall Evaluation

What is your overall assessment of the performance of the Audit Committee?

7 Adapted from materials prepared by KPMG's Audit Committee Institute, "An Approach to Effective Audit Committee Evaluation," April 2003, www.kpmg.com/aci/docs/selfevaluation.pdf.

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