



EXECUTIVE IN RESIDENCE

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"Recent Developments in Corporate Governance from the
Perspective of a Lead Director"
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I am honored to speak to you today about a topic close to my heart: Governance and how public companies manage to survive and thrive in today's highly regulated markets.

I do not need to remind anyone this afternoon that Boards of Directors spend a great deal of time complying with a multitude of rules focused on monitoring what is happening both inside and outside the Corporation. Compare this to only 10 to 15 years ago, when boards acted as resources for management and as representatives of shareholders: a much simpler world in retrospect. A great deal of this change has been brought about by a multitude of agencies and commissions, which have all been established through the legislative process. I will provide you some perspective and make the point that not all of this legislation has served the corporate sector or our nation very well.

A leading American conservative sociologist, Robert Nisbet in an essay titled "The New Despotism", written in 1975, foreshadowed that the bulk of power in our society would shift. He predicted that this shift would impact not only our personal lives but also the lives of our corporations. How right he was.

Going back even further, to the end of the 18th Century, the great philosophers of our modern institutions, including Montesquieu, Burke, Adams and Jefferson, never envisaged that elected government might some day establish and delegate their powers to such agencies and commissions running our lives and limiting our freedoms. The aims of the philosophers appear to have held up quite well for over 100 years since Nisbet, who was born in 1913, commented several decades later that in the year of his birth, the only contact most Americans had with the U.S. Government, was the Post Office. The same statement could have applied to our corporations.

As the 18th Century provided us with great philosophical thought, the 19th Century provided us with capitalism in its purest form. The Mellons, the Carnegies and the Rockefellers, men of great wealth, influence and power reigned almost like kings with unlimited powers. The 20th Century brought a huge shift of power from individual to multiple ownership: shareholders, who elected Boards of Directors to represent them. Boards of Directors in turn appointed management and together they ruled their corporations, again with almost unlimited power, frequently across national borders. In the

latter part of the 20th Century and now into the 21st, we see as yet another shift: from the power of boards, to vast armies of accountants, lawyers and regulators, essentially reigning supreme over the Boards they advise to stay out of trouble, if not out of jail.

Today, the power of Government is exercised through unelected agencies of government, impervious to the very legislative bodies which created them.

I said "impervious", since it becomes almost impossible to change the rules once an agency has been established.

Justice Brandeis warned against this a lifetime ago when he said that the greatest dangers to liberty lurked in insidious encroachments by men of zeal, well meaning but without understanding. Unfortunately, a handful of companies have severely undermined the confidence of the public, so critical to the success of our capital markets. I will now suggest to you that despite the recent developments in the regulatory arena the result, on balance, is positive.

The Corporate sector has recognized that something went awry with our Governance the last few years. This was the main reason why Boards of Directors have embraced this new world. This is not to say they had an abundance of options.

The financial markets have served this continent and the rest of the world well since the days of the early philosophers. Up until about ten years ago, regulatory change was minimal. Since that time, change has been dramatic.

My major concern is that the full impact of what has happened in the regulatory arena may not be fully understood for years to come. To give you but one example is to consider the role of New York as a global financial center. New York's position has been damaged, possibly irretrievably so.

It is interesting to note that London was the financial capital of the world in the late 19th Century. Young entrepreneurs seeking capital and finding more of it in New York, with less regulation, in a matter of only two years, made that City the financial capital of the world.

Last year, John Thain, CEO of the NYSE, suggested that during 2005, 24 out of the 25 largest IPO's were not registered in the US. The numbers for 2006 were no better. Interestingly, the money to fund these IPO's, registered overseas, still comes overwhelmingly

from the US.

For my discussion today I will rely on 4 primary sources, without quoting them each time:

1.) Articles written by Marty Lipton of the law firm of Wachtell, Lipton. My Bank in the mid 80's, when we could still afford him, had the good fortune to rely on Marty for a great deal of corporate advice;

2.) Articles written by Clyde Mitchell, Adjunct Professor of Law at Fordham University. Clyde, who is a close friend, teaches advanced banking law and is retired from the International law firm of White and Case. Clyde's articles appear frequently in the New York Law Journal;

3.) My participation in Director College seminars, sponsored annually by Stanford Law School for Directors of public companies. The SLS seminars are top of the line. I have made use of several their articles, and

4.) My own experience as a (Lead) director of a public NYSE listed corporation, as Chairman of a highly regulated Bermuda insurance captive, headquartered in New York with a separately incorporated UK Company, to an aircraft parts company, in California, which I chair to a Genetics Company in Virginia, where I serve on the board, to a CalTech VC Fund and 2 non-profits, one of which I chair. All these entities are regulated not only in the US and Canada but also in several foreign jurisdictions.

Let me make a point of disclosure since it may come up during Q & A. My first experience with the SEC was in 1971, when I was fresh out of UBC law school. Some of you may recall that National Student Marketing, NSM, headquartered in New York, was one of the Go-Go marketing firms in the late 60's. The Vancouver Sun, in my last year of law school, ran an article about young millionaires. Allow me to clarify; they were "Paper" millionaires, an important distinction, as it turned out. The article listed several such millionaires from Canada, including me. NSM stock went from \$6.00 to \$176.00 in a matter of 18 months and down to .50 cents in a matter of weeks if not days.

Early on in the excitement for all of us when it seemed that making money was easy, I told my father, back in Vancouver, that I was earning a great deal of money in New York. He said; let me tell you something young man: "Someone may be stupid enough to pay you that kind of money but don't you ever believe you have earned that kind of money." I have quoted him many times since

After the SEC intervened and the entire NSM senior team had left, I ended up running "the good company" as well as taking care of some 400 law suits, as Associate General Counsel. I had taken over from our General Counsel who was on his way to Allentown jail and, unfortunately suicide. Not an encouraging start for a young, eager, Canadian law school graduate trying to launch a career in New York. It was a useful experience nevertheless.

I might also add that National Student Marketing had been represented by several leading law firms, one of which never regained the prominence it once enjoyed, particularly in securities law. My involvement early on in my career confirmed that the long arm of the SEC, whose young attorneys, wielding great power, would have had trouble finding work in first class law firms and seemed to resent it.

That, admittedly has changed dramatically, as the Government has recognized that to attract quality staff, the SEC must pay competitive wages. That does not mean competing with the private sector since having been employed by the SEC pays valuable dividends in a subsequent job search.

I also want to suggest that Governance, in my mind is not a matter for "Public" companies alone. I believe that the standards which apply to public companies are already being applied to private companies. As a result, I have tried very hard in all my corporate roles, public, private or non-profit, to govern ourselves appropriately with quality board members, board committees, committee charters, disclosure of conflict, executive sessions, excellent record keeping and the best possible transparency. Also, incidentally, making sure we have top quality CEO's. This, incidentally, has served us well. The Bermuda insurance regulator told me last year that we were one of the very best governed companies in Bermuda.

Let me now back up a little and raise a few governance issues which, in my mind, are critical to organizational health and well being.

CORPORATE CULTURE AND ETHICS

If you have it right, you can succeed.

If you do not have it right, you will surely fail.

Corporate culture goes beyond empty statements one can find in almost any company publication. We have all seen the misdeeds at Enron, at Worldcom, at Global Crossing, at Adelphia, at Tyco and others. Most of these companies had committed themselves, in writing, to the highest ethical standards. In spite of this and, in several cases, their outside directors were severely punished as they should have been.

Their lack of commitment to proper oversight or, in certain cases, greed, has undercut confidence in our financial markets and has led to a huge financial burden on our corporate sector.

Board members have been replaced as have CEO's. Independent and financially literate directors have been appointed. Boards are now engaged in learning about the Company's business, its people, its practices and its risks. Compliance is now a way of life and programs are in place and are being implemented, to ensure that employees, from the top down, are behaving ethically.

We can now assure a whistle blower employee that his or her career will not be placed at risk. Whistle blower hot lines are in place at many companies. Companies are civilly, if not criminally, liable if it can be shown that they took retaliatory action against whistle blowers.

I mentioned that culture emanates "from the top". Unless the members of the Board, the Chairman, the CEO and all of the senior officers, walk the walk and talk the talk, no amount of fancy statements in a Company's publications will suffice.

Corporations need to stand for "How" they do things over "What" they do. Ethics and ethical behavior must be instilled throughout the corporation over time. One can not simply put it all in writing, make speeches, throw the switch and assume the job is done.

A day-in, day-out profound commitment to ethical behavior must be made. Proper education across the organization, over time, must make the process one of self governing for each and every

employee. Ethical behavior must become a way of life.

I believe that members of a Board should have full and complete access to management of the Corporation and its affiliates, without supervisors present. Directors should be encouraged to visit the Company's operations and attend management meetings allowing for ample opportunities for informal exchange of ideas.

We must reward good behavior and, discipline unacceptable behavior. Everyone must be committed to perform at the highest standards. The ethical employee should be the rule, not the exception, let alone be the laughing stock.

THE ROLE OF THE BOARD

Any Board needs to strike a fine balance between the historic advisory role and the more recently imposed monitoring role. To address this, there are several items of importance to the proper functioning of a Board.

a.) Independence

The days of the Chair and CEO inviting all of his/her friends onto the Board who, in turn, invite him/her onto their Boards and making important decisions on the golf course, are over. Boards now have Nominating Committees whose primary role is to find and attract well qualified men and women with the appropriate business experience. Board members must be objective and committed to serve the needs of the Corporation.

Boards must be committed to diversity not by counting heads or finding token members. Instead they must focus on finding the best possible people who, in turn, just might happen to be women or minorities. I firmly believe that if a board is truly committed to diversity, its goals can be achieved.

Boards must be able to work together in reasonable harmony. Board members must be available when needed. Strong, independent directors are essential to a proper functioning Board. Board members must be vigilant to ensure that no member is conflicted since conflict frequently is not obvious to the Director in question.

I also feel quite strongly that Board membership is a matter for the Board to decide, not management, although I readily admit that one should not exclude the CEO from the process, nor should the Board hesitate to involve selected executives where the new board member is likely to interact directly with them.

b.) Succession Planning

In my mind there are three components to this issue: (1) that a succession plan for the CEO is under constant discussion, most likely with him/her and the Lead Director; (2) that the CEO discusses succession of the critical members of the executive team with the Lead Director and/or the Board on a regular basis, and (3) that the executive team has discussed succession at each and every one of the major business units with the Board.

Most Boards recognize that "promoting from within" is frequently the best available option. These insiders will have grown up with the Company and will be broadly familiar with its business and its culture.

There is a great deal of sensitivity around each of these areas, particularly where a new CEO is barely in place and may well wonder whether the Board is already considering replacing him or her. Also,

when agreeing with a CEO that his or her likely replacement may come from within, the relationship between the two must be closely monitored. Best is to stay close to the CEO while keeping his or her succession plans absolutely confidential particularly so where there is no immediate need to consider his/her succession.

This last thought is important, in my opinion, since an anointed successor, if known, may see him or herself as a kingmaker, while his or her colleagues and, their spouses, may want to ensure that he or she never gets the job, causing unnecessary politics around the organization.

Where possible, the Board must be prepared to invest in surplus executives and employ them in challenging roles. This ensures that back up is available should it be required. The same applies to key divisions where potential replacements may be "warehoused" to prepare them for the day when they might be needed on short notice. If handled correctly, a well thought out and properly executed succession plan will be well received by all stakeholders, including investors and employees since no one likes surprise.

c.) The Lead Director

I will explain why I believe that this is one of the more constructive ideas to have emanated from recent developments in governance.

Before the role was ever formalized, there is no question that many boards had "lead" directors, although they might not have been referred to as such.

I believe that the most useful part of the role is the recognition that for boards to work harmoniously, it requires a Director appointed for that purpose to orchestrate relationships between board members and the CEO. A good Lead Director can significantly reduce the number of board issues, particularly sensitive issues, leaving the CEO out of the fray.

In the past the role of Board coordinator or resolver of board issues and disputes pretty much defaulted to the CEO, who, reported to the Board and, as a result, might find it challenging to deal with personal issues involving directors. More often than not, these issues would be avoided.

Presiding over executive sessions of the board, orchestrating CEO appraisals, orchestrating board and committee appraisals and chairing the annual offsite, has made for better functioning boards. Not reappointing less qualified board members, dealing with conflicts, addressing excessive demands from board members, or board members not receiving adequate support to do their jobs, is always done more easily by a board member appointed for that purpose.

I have insisted on having my performance, as Lead Director evaluated regularly, usually during the annual board offsite in executive session and in the presence of the Company CEO.

My preference is to make sure that the minutes reflect that appraisals took place. We do not maintain detailed written notes of appraisals.

d.) Board Committees

The NYSE rules require a minimum of 3 board committees all made up of independent directors: Audit, Compensation and Nominating & Governance. Each of the companies, public or private I chair, or where I serve as Lead Director, has these committees. All committees are entitled to retain consultants but must be careful, in my mind, never ever to delegate responsibility for decisions to consultants.

I also believe that committee members receive adequate training. The Lead Director should also plan for succession for him or herself and for committee chairs.

I insist that each member of the Audit Committee is a financial expert and remind all members of the Board, at least annually, that each member, individually, is responsible for the actions of every Board committee whether or not they are members of that committee.

This ensures that members will be encouraged to quickly weed out other members in whom they do not have sufficient trust or confidence and who are not totally committed to exceptional performance. In my mind this process, if handled well, obviates an important part of the need for individual board member appraisals, which, in the minds of some, can place a board member's independence at risk.

I believe that all of this encourages harmony and underlines the notion that all of us are in this together. Board Committee meetings are scheduled consecutively so they can be attended by any member of the board who chooses to attend. All members are encouraged to attend and to participate in the discussion, particularly where there are important matters to discuss. Non-committee members do not vote during committee meetings.

Unlike the past when minutes would contain the least amount of information "so we would not be caught", today's minutes more properly reflect the discussion, the decisions and, where appropriate, the rationale for the decisions. That avoids potential challenges that the Board was uninformed or did not adequately address a particular issue. We are also careful to note attendance.

In order to avoid confusion at some future stage as to what was discussed and what was reflected in the minutes, it makes good sense always to destroy hand written notes after the formal minutes are approved. I discovered during one of the sessions at Stanford a couple of years ago that this was done routinely by directors of public companies and is deemed quite acceptable.

Whenever it is practical, either as Chair or Lead Director, I try to advise non committee members of important items for discussion beforehand, so as to encourage discussion and avoid surprise.

Board Committee reports are made at the Board meeting and to avoid duplication, reports highlight key points discussed in summary form and approved.

If there is a need for a Special Committee of the Board, my preference has been to make these committees of the full board. Since decisions made at these committees are often important, one should be sure that no board member is caught off guard. Where, in a couple of cases, it was impossible to bring everyone together, arrangements were made for committee members to "officially" keep other board members current: to solicit their advice and provide their input.

e.) Executive Sessions

Regular executive sessions should be scheduled during board and committee meetings. We try to keep the sessions informal. Frequently there is nothing to discuss, which is fine. Calling sessions periodically, can make executives unnecessarily nervous that "something" is afoot. The Lead Director keeps the CEO informed. Highlights of executive sessions, usually limited to topics only, are included in the minutes. Where there is a need for extra sensitivity, the issue is not included.

f.) Executive Compensation

Having chaired a public company compensation committee and having served on others, I can assure those of you not fully familiar with the work involved, particularly after recent regulatory changes, that the work is extremely time consuming. If, as Chair of a Compensation Committee, you find the job easy, you are probably not up to the task. Worse yet, you may put the Company and the reputation of your fellow board members at risk.

First and foremost the Committee should retain a reliable compensation consultant who must be beholden to the Board through the Compensation Committee. This is not to suggest that senior management, particularly the CEO, should be excluded from providing input. Having been at the other side of it, I can assure you that most certainly in the past, compensation consultants were well aware of who retained and paid them. This has contributed, over time, I am convinced, to inflation of executive compensation.

The Compensation Committee's decisions cannot be "too" far off the mark. If you are too high, your shareholders will get to you, if you are too low, your best executives will be gone before you know it. Remember also, that your potential detractors, including shareholder activists, have the benefit of perfect hindsight.

A useful suggestion also is to assume that whatever you decide, including in executive session, is likely to be in the public domain before long and I suggest that you discuss and test your rationale for important decisions beforehand and maintain good records, just in case.

Another major challenge is to find a group of peer companies. These will ostensibly provide insight into what you should be paying your executives. The problem is that few of these peer companies are comparables and even if they are, you will only obtain cash and equity comp ranges for the previous year. Making it worse, you are not likely to lose your key personnel to comparable positions with peer companies.

More likely than not, your key personnel might be head hunted for higher positions with peer firms or by related industries. The problem, particularly in the area of financial services and, particularly so if the market recognizes your executives as "leaders", every head hunter will be "seeking their advice". In our case and, until recently, we were most vulnerable to a myriad of private equity and hedge funds. You can work hard, do everything right, yet still lose your key people.

Yet another challenge for many companies on Wall Street is the notion that more money will retain key employees. That notion no longer holds true. There are people who have made \$100's of millions, who want to retire at a young age, or spend time with their families and/or go fishing. No amount of money will keep them.

I believe that a sound process which has been accepted by analysts and investors alike is to guarantee the investor a certain minimum return and to agree a sharing formula above that level. You also need a minimum pool which can be used for purposes of accrual. If the minimum earnings goal is not met, the minimum pool can be utilized at the sole discretion of the compensation committee.

All long term compensation programs must be projected out for at least five years under various scenarios. The Compensation Committee must then decide whether potential future payments appear reasonable under the various assumptions which were made. Similarly, potential payments under severance agreements need to be

projected using the same assumptions.

Finally the decision in the Disney case has, on balance, been instructive. The Delaware court applied the business judgment rule, telling boards that as long as they act on an informed basis, in good faith, not in their own self interest and maintain adequate records of the deliberations and decisions, a court with the perfect benefit of hindsight, will not penalize a Board.

A few words on the Disney decision. The Delaware Supreme Court in affirming a lower court decision, held in June of 2006 that, where the Disney Company had employed, Michael Ovitz, as President for a five year term, then fired him without cause 14 months later, and paid him \$130. million in severance, that the directors did not breach their fiduciary duties or committed waste, as was claimed by several Disney shareholders in a derivative suit.

g.) Director Compensation

If worrying about Executive Compensation is not enough, now boards have to worry about and decide upon their own compensation in the full knowledge that here also, critics have the benefit of perfect hindsight.

There is no question that the workload for directors has increased greatly, as has the perceived risk of liability. Past compensation did not properly reflect either.

Working with compensation consultants, my approach has been to monitor peer companies, determine total cash and equity paid to the entire board and calculate an amount per board member. We recognize that for similar size firms, smaller numbers of independent directors, carry a heavier work load, relatively speaking and are entitled to higher individual compensation.

I was interested to note that a study done to look at Governance in the Canadian Resource and Energy sector by UBC's Dr. Janis Sarra, present here this afternoon, confirmed my suspicion that corporations today have fewer directors and that the percentage of independent directors is greater.

Finally, we review at what percentile of cash our company's directors rank versus peers and, similarly, based on Black Scholes, for lack of anything better, do so for equity and total compensation. Perquisites can be reviewed individually. These most commonly include charitable gift matching, life insurance and tax advisory. Perquisites are far fewer today than they were only a few years ago.

A key topic recently has been the issue of options versus restricted stock. In the case of options, directors may benefit from a rise in stock value but equally so, lose all when a stock price declines. In the case of restricted stock, a director tends to limit his/her upside yet have a safety net on the downside. Until a meaningful risk adjusted option versus restricted stock formula has been devised, the issue may well remain with us for some time.

WHAT IS NEXT

Surely more regulation.

Taking that as a given, I have been rather concerned about as yet another fall out of Enron which is a theory that expands the liability of financial institutions. This theory suggests that such institutions be charged with ensuring compliance with federal securities laws of their clients and the vendors of their clients.

All this may well be decided as early as next month by the US Supreme Court in the Stoneridge v. Scientific Atlanta case, No. 06-43.

The plaintiffs in the Stoneridge case hold that when a U.S. public company misrepresents its financial condition, not only would that firm be liable to its shareholders but also, and this would be new, so would any third party vendor who participated in fraudulent transactions with that company. This would be so even though the third party did not participate in producing the fraudulent statements and had no obligation to disclose to the plaintiff shareholders.

This is a key case for banks since following the Stoneridge case, the Supreme Court will hear Regents of the University of California v. Credit Suisse and 2 other major investment banks. Here the Fifth Circuit Court held that while Enron had a duty to its shareholders, the banks did not. Not unlike the vendors in the Stoneridge case, the banks were deemed to have engaged in a fraudulent scheme with Enron.

If the Stoneridge case goes against the banks extending their liability, this will dramatically change how such banks will manage their relationships and their risks and probably drive yet additional business away from these shores.

The case is considered the most important securities case to come before the Supreme Court for years. Over 30 parties have filed amicus briefs with the Court.

As a businessman I am greatly concerned that, coming on the heels of Sarbanes Oxley legislation, this potential spreading of liability might have the perverse effect and, here I quote Eliot Spitzer, of decreasing the volume of securities business subject to US laws as increasing numbers of companies will seek to raise capital through public listings abroad.

Henry Paulson agrees, stating last week that the cost of abusive litigation is the "Achilles heel of our economy". Paulson asks whether saying "YES" to the trial lawyers, will damage the U.S. Investment environment more than it is already damaged.

Coming back for a moment to the title of my comments: "Recent Developments in Corporate Governance", I suggest that all of us remain vigilant in recognizing that there is a cost to all of this regulation and litigation, carried out by regulators and trial lawyers and, in the latter case, allegedly in an effort to save ourselves from ourselves.

I believe that many of my fellow public company directors might agree with Justice Brandeis, whom I quoted earlier, when he said: that the greatest dangers to liberty lurked in insidious encroachments by men of zeal, well meaning but without understanding.



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