THE HONORABLE BARBARA HACKMAN FRANKLIN
LEADING THE WAY: DIRECTORS STRENGTHENING CORPORATE GOVERNANCE
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REMARKS AS DELIVERED

Good morning!

There is the old Chinese proverb – "May you live in interesting times." That is an understatement today. What a time to be a director of a public company.

I have been a director since 1980 and have served on 14 public company boards, with time off to be Secretary of Commerce. In all of this time, I have never seen such volatility in the business environment – both economic and political. And public trust in American business is at the lowest ebb in my memory. In the most recent annual Gallup Honesty and Ethics poll, business people reached a new low, even with Congress, and just a cut above car salesmen, telemarketers, and lobbyists. This lack of trust is troubling. As a believer in the American system of entrepreneurial capitalism which has produced the world's largest and most dynamic economy, I believe we cannot allow this lack of trust to persist. If we do, over time there will be irreparable damage to our great economy.

In the early part of this decade it was the scandals at Enron, WorldCom, and others that caused an erosion of public trust in American business. These scandals were rooted in fraudulent and illegal activity; Sarbanes-Oxley act was the response of the U.S. government. It aimed to correct the abuses. That law and the regulations that came with it gave more power and responsibility to us – to boards of directors.

Now, public trust has been damaged again, this time by the financial meltdown and global recession. Boards of directors were certainly not the cause of this downturn but we are getting our share of the blame, nonetheless, along with CEO's and the way corporations are governed – or not.

Again, the U.S. government has stepped in to rescue our financial system and shore up our economy. Along with this wave of government involvement has come a push for more shareholder power in the boardroom – a push to hold directors more accountable.

We are probably all familiar with the various items included in the "Shareholder Bill of Rights" which are embodied in various pieces of legislation introduced on Capitol Hill. But let's focus just on say-on-pay, proxy access, and majority voting.

- **"Say-on-pay."** This would give shareholders an advisory vote on a company's pay plans. The firms receiving government bailout funds already have this, and the expectation is that the Congress will pass a bill making it apply to all public companies. This has already passed the House. As we all know, executive compensation continues to be a source of anger on Capitol Hill and around the country.

- **Proxy access.** A rule has been proposed by the SEC. The comment period has closed and the agency is reviewing the comments. If enacted, this would allow shareholders owning a certain percent of a company's stock for a specific time period, to place director nominees directly onto the company's ballot for vote at the annual meeting. This would be much easier than the current process. Other changes are afoot to make proxy access easier. For one, Delaware has changed its corporation statute to allow companies registered there to incorporate proxy access into their bylaws.

- **Majority voting**. Already, many large companies have a majority voting standard, which means that a director must receive a majority, not a plurality, of votes cast to be elected.

Use of these powers – if enacted – in combination by shareholders could change the dynamic in the boardroom among directors, management, and shareowners. The bottom line is this: A realignment of boardroom power is probably ahead.

What should boards do?
This brings me to the crucial question – what should boards of directors do now?

In my experience, directors are working valiantly to do a good job, and boards are performing better than they ever have before. As directors we are more engaged on strategy, "tone at the top", succession planning, risk governance, and operations oversight. I'm proud to be a director. I think this is important and worthwhile work, and I'm sure you feel that way too or you wouldn't be here today.

But, still, it is time for another step up in vigilance and performance. These are tough times and probably will be for the foreseeable future. We as directors have a responsibility to be part of the solution – to do our part to help restore trust in corporate governance and in American business, help to build long term value for shareholders, and do our best for the company as a whole. This is a call to action and it is urgent.

Here is what I believe we, as directors, must do. I am talking to myself as well as to you.

First, rededicate ourselves to understanding fully the companies we serve. How does the company make money? What is the strategy? What are the drivers of success? What are the risks? How strong is the "tone at the top"? Does the company make money by also doing good – by providing products and/or services which are needed and useful? If we are not really knowledgeable, we cannot do an adequate job of overseeing performance and engaging in these important decisions regarding strategy, risk, and succession.

Also, we should rededicate ourselves to the qualities of character all of us, as directors, must have – integrity, good judgment, a commitment to excellence, a strong work ethic, independence, and courage. And each of us should know what we bring to the board table through expertise and experience, so that we can use that expertise and experience to help the company.

Second, reevaluate how board members work together. A board, as we all know, is a group usually of 6–12 people. So it must do its work as a group, by consensus. A key dimension of board effectiveness – often overlooked, I believe – is the group dynamic at work around the board table and also, importantly, how the group interacts with the CEO. There are a variety of cases where person for person, the directors sitting around the board table are excellent people. Yet somehow the group process didn't work well enough or quickly enough when action was needed. We board members should look at ourselves and be honest about how things are working.

Some questions to ask: Do board members respect each other? Do they trust each other? Are they willing to challenge the CEO in a constructive way? How do they deal with, for example, an overpowering CEO? Is leadership of the board – lead director or independent chairman – working well? These and other questions should be asked and answered. Where different behavior is called for, the board should make that happen.

Third, participate in NACD's campaign – "Leading the Way: Directors Strengthening Corporate Governance." The hope is that every board in the country will reevaluate its governance structures and its performance. The NACD provides a splendid tool – the "Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies." This is a unique document. It was a year and a half in preparation and represents the distillation and articulation of a variety of governance principles on which we believe there is agreement from management, directors, and shareholders. There are 10 principles, quite logical, really: (1) board responsibility for governance (2) corporate governance transparency (3) director competency and commitment (4) board accountability and objectivity (5) independent board leadership (6) integrity, ethics, and responsibility (7) attention to information, agenda, and strategy (8) protection against board entrenchment (9) shareholder input in director selection and (10) shareholder communications.

We ask each board to evaluate its practices against these ten principles. Use them as a framework, and where the board needs to strengthen its practices, do so. Then, repeat the evaluation process every year. An easy way to do this is to integrate this evaluation into the annual board self-assessment which public companies must do in order to meet stock exchange listing requirements. The season for those assessments is often the fall of the year – now – so it's the opportune time to begin the process with your board. I want to emphasize that these principles are not prescriptive. They are not a "cookie cutter" one-size-fits all list of do's and don'ts. We hope each board will evaluate its practices and then strengthen its performance in whatever way it sees fit.

The NACD is giving recognition to those boards which participate in this campaign. Some of those so far are: Aetna, Dow Chemical, Home Depot, United Health, Becton Dickinson, and Whirlpool. We have a new website to help in this effort, and Ken will tell you about that and other resources. And when we have a good number of boards participating, we can communicate this fact to public policy makers on Capitol Hill and in the Administration. We want them to know that directors really are stepping up and making a difference.

An obvious question I have been asked: will such a voluntary effort on the part of boards be enough? Can this help to prevent another economic crisis? Will it stop future fraudulent activity?

Of course, there can be no guarantees. But I truly believe that more effective corporate governance and more vigilance on the part of each and every one of us can contribute significantly to a company's better financial and ethical performance.

As we said, these are challenging times for directors. But the flip side of challenge is opportunity. Before us now as never before is the opportunity to show that boards can perform even better and help to restore public and investor trust. That in turn can help to boost our economy. It is in the interest of everyone – shareholders, managements, boards, employees, the public, and yes, our government – that we directors succeed in proving that corporate governance really works for the good of the company and that our American system of capitalism really is the best.
Thank you.

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