

CHANGING THE WORLD: ONE RESOLUTION AT A TIME
The critical role of ICCR in influencing companies to act ethically and morally

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I have entitled my talk today: “Changing the world: One resolution at a time - The critical role of ICCR in influencing companies to act ethically and morally.”

Let me begin by saying a few words on the current market environment shareholders are operating in.

If you have a bit of time to kill and you Google “corporate scandals”, you will be presented with a few hundred thousand pages to pursue at your leisure. From Enron, Adelphia, Tyco and WorldCom to a host of slightly lower profile examples of corporate sleaze, the past few years have demonstrated that if we don’t keep a close eye on those in the boardroom, then they (and those that they are charged with monitoring) have the potential to get involved in all sorts of shenanigans. We are emerging from a period in which we have seen countless examples corporate distress and a severe weakening of investor trust and confidence.

As investors, this is worrying. Not only because poor governance could result in immense collapses and losses in the billions, but because it doesn’t require complete self-destruction for a company to be a poor investment.

Which means that perhaps the most important issue facing American corporations today is, in my opinion, improving and strengthening their governance structures.

Fortunately, as shareholders, you have the tools and the collective voice to help make this happen.

Case in point -- institutional investors (and, yes, you are institutional investors) now hold more than half of all listed corporate stock in the world. The largest 25 pension

funds account for 42 percent of foreign equity held by U.S. investors. Institutional Investor ownership of American Corporations is now at 65%; and believe me, corporations are keenly aware of that fact.

CalPERS, my former employer, and one of the largest public pension funds and most active in the governance arena, has seen its investment portfolio balloon in recent years. When I joined CalPERS in 1986, the pension fund had a mere \$28 billion in assets, and when I left in 1996, over \$100 billion. Today, CalPERS manages nearly \$170 billion. Sixty-five percent of that is in the stock market alone.

Backed by these staggering portfolios, corporate governance and investor activism has come of age, especially during this most recent current proxy season.

This is clearly demonstrated by the record number of shareholder resolutions placed on the proxies of Corporate America. According to the Investor Responsibility Research Center (of which I am proud to be a director!), there have been over 1,200 shareholder proposals placed on proxies so far this year, exceeding the previous record of 1,082 for all of 2003.

Resolutions calling for limits on executive compensation are the leading governance issue with about 195 so far. That includes proposals calling for the expensing of stock options.

In some cases, investors are getting more by saying less. They are withholding proxy votes for directors who have not acted in accordance with shareholder wishes on corporate governance or performance.

Early this year, vote withholding reached a record high at the much publicized Disney meeting, when Chief Executive Officer Eisner was stripped of his chairman title after 45 percent of shareholders – a huge amount by historic measures – declined to support him (and this vote has now been surpassed this proxy season by two other companies - MBNA at 49% and Federated at 61%!). The anti-Eisner campaign was energized by an unprecedented display of investors ire, and the movement is proceeding. Please, do not underestimate the power of the withhold vote on directors, when used selectively, and not indiscriminately!

Corporate monitoring has also increasingly become an international movement as well. Note the principles set forth by the Organization for Economic Cooperation and Development (OECD), and the initiatives of the World Bank and the IMF. Observe the codes of conduct put into place by dozens of individual countries worldwide.

And most important, the breadth of activism is wide, thanks to all of your important individual work, and the work of ICCR generally.

Eliminating sweat shops, human rights in Columbia, emissions reductions, ending the use of racially offensive images and promoting women in the boardroom are all issues about which a growing numbers of shareholders want some corporate action.

And shareholders are also filing scores of social policy resolutions - 340 so far this proxy season! They are using investor clout to force companies to behave in more socially and environmentally responsible ways.

We can all agree that not attending to social and environmental problems is just another way of mismanaging corporate funds, although it just doesn't have the visibility of corporate officers caught with their hand in the till -- at least not yet.

And socially responsible investing is growing in popularity. According to the Social Investment Forum, about \$2.16 trillion was invested in socially responsible funds last year, up from \$1.19 trillion in 1997. And, I understand that a State Street study (yes, State Street) is about to be released that links good environmental practices at companies with a good bottom line for shareholders!

Today, more than \$1 out of every \$9 under professional management in the United States is involved in socially responsible investing.

More than 11 percent of all investment assets under professional management in the U.S. are in professionally managed portfolios utilizing one or more of the three socially responsible investment strategies that define socially responsible investing in the United States -- screening, shareholder advocacy, and community investing. That's \$2.16 out of \$19.2 trillion. Very impressive!

Screening is working both ways. Investors can avoid companies that disagree with their values, but they also seek to invest in companies that are good corporate and environmental citizens. Shareholder advocacy is when the ownership of shares is used to apply pressure to a company to be better corporate citizens. And community investing is just that. Investors utilize community banks, credit unions, and developmental loans funds to make their dollars available for individuals and businesses that are under-served by the traditional banks.

And socially responsible investing is also growing globally. We are now seeing screening and shareholder advocacy from U.K. pension funds, as well as a multitude of small-scale community-investing initiatives reaching millions throughout Asia. There is also a wide array of socially responsible investment products available in more than 21 countries.

I see this rise in popularity to be two-fold. First, there is strong evidence (soon to be supportive by an old line financial institution like State Street!) that socially responsible investing is highly competitive with the broader market. And second,

investors are not only getting good returns, but feel also they are encouraging greater corporate responsibility.

As social investing continues to grow, it continues to change. The issues that social investors use as screens have evolved over time. For example, divestment from South African companies is no longer an active screen since the end of apartheid. However, climate change and environmental management systems, human rights and supplier codes of conduct, and genetically modified organisms have developed into increasingly common social screens.

And I believe, and hope, that corporate governance, while used as a factor for consideration in investment decisions, is likely to materialize as a formal social responsible investment screen in the near future as well.

The most exciting aspect of the evolution of social investing (personally for me) is a convergence of strategies, combining advocacy for SRI and corporate governance. In recent years, there has been a rise in the number of social investors employing avoidance and positive screens combined with shareholder advocacy of engagement/dialogue with companies.

And, SRI investors are also recognizing the importance of corporate governance. ICCR members have floated a number of shareholder proposals at companies this season seeking to separate the positions of Chair and CEO and to declassify the board.

Now, in other parts of the market, some portfolio managers and advisers go beyond social screening to invest a percentage of their portfolios into community-development financial institutions. And labor unions and pension funds are exercising their proxy for change in an ever-increasing way.

For example, at the behest of the California State Treasurer, the California Public Employees' Retirement System (CalPERS) is going to begin to examine how to encourage corporations to provide meaningful, consistent, and robust reporting of their environmental practices, risks and potential liabilities.

As more and more investors put their faith-based beliefs first, there is a growing realization among corporate leaders and academics that the adoption of principles of sustainability can offer substantial long-term investor value.

For example, the UPS fleet includes 1,800 alternative-fuel vehicles. Nike has removed vinyl, which has been linked to cancer, from almost all its footwear. It has also developed a program with Delta Air Lines called Eco-Class, which invests in projects that offset emissions created when Nike employees take business trips. To preserve biodiversity, Starbucks is buying more organic and shade-grown coffee. It is also buying

more “fair trade” coffee, which gives the owners of family farms an agreed-upon price for their harvest.

And, moving beyond shareholders, I think it is important to note that there are other highly ethical companies and institutions that are trying hard. It is important to remember that there are many good corporations, professional advocates and business managers who want to promote a culture of higher ethical standards.

Johnson & Johnson is arguable one of the most admired and trusted companies in the world. And J & J takes ethics very seriously. Its commitment to incorporating values and ethics into its business philosophy has been at the core of its success for many years.

The company holds a five-day leadership program for its senior management and directors. Included in the program are lectures on ethics and values led by the most senior people in the company.

Johnson & Johnson’s credo is a simple management philosophy that says its first responsibility is to its customers: to give them high quality products at fair prices. The second responsibility is to its employees: to treat them with dignity and respect and pay them fairly. Third, to its communities in which it operates: to be good corporate citizens and protect the environment. And finally to its shareholders: to give them a fair return. A philosophy that has made long term winners of all those stakeholders.

Pfizer also deserves a nod for their commitment to good ethics through education of their directors. New directors get 20-25 hours of independent or company education on the types of things they should be looking at. Before board meetings, they get information on the issues and the types of questions they should ask. The same is true of the compensation committee. This is all part of a philosophy that it’s okay to ask questions at Pfizer, and to understand that directors are representing the fiduciary interest of shareholders.

And lastly, the Target Corporation, should be recognized for its fundamental good corporate citizenship through its program, established in 1946, that invests 5% of its federally taxable income in the communities in which Target serves (currently at \$2 M a week!).

And more individuals in the corporate world are beginning to listen and act. Note what Jeff Immelt, the CEO of General Electric, said recently to his constituents, “*Sound principles of corporate governance are critical to obtaining and retaining the trust of investors – and to GE’s overarching goal of performance with integrity. They are also vital in securing respect from other key stakeholders and interested parties, including employees, recruits, customers, suppliers, GE communities, government officials and the public at large.*”

All of these examples are evidence that shareholder activism is working. You should applaud yourselves for a job well done. I do believe that your, and my, hard work of the last 20 some years have laid the groundwork for fundamental, lasting economic change.

Now, while it might be nice to linger over these victories, there is much work yet to be done to clean up corporate America. Even as a handful of large corporations move toward sustainability and more enlightened behavior, there are many which have not.

You have to ask yourself some questions. How can SRI successes be repeated? Is there a way to not take decades of work and yield even more influence on corporations?

We know there is one constant to ensure that our corporations have good governance, and a social conscience to help build and sustain wealth, and protect our world. Certainly, all involved must lead the way to change.

But I think the true answer for lasting change in our corporations takes us back to the basics of corporate governance. I would like to offer you seven of my own ideas on what this might entail:

1st We need to start with the Board of Directors and setting the tone at the top. According to SEC Chairman William Donaldson, a board's number one duty is this: "Setting the moral DNA of the company and allowing everything else to follow from that."

And boards must continue to become more independent of management and much more diverse beyond the old boys network and the executive management club that has too long dominated America's corporate boards.

Corporate America (as well as lawmakers and regulators) need to learn that true independence of the board of directors is one of our most important safeguards, and the cornerstone to the success of our financial markets.

Corporate Boards need to voluntarily adopt comprehensive and vigorous corporate governance guidelines and begin to take steps to act, and be, more fully independent. Virtually all the checks and balances designed to prevent an Enron disaster failed. Enron's board wasn't lacking the skill, corporate experience, and diverse perspectives that's important to guide a company. Rather, they were shy of the one factor espoused by institutional investors and corporate governance advocates in recent years – a clear lack of independence from management.

In addition, Directors need to be out in front, doing what is right, not just what's legal or possible. A start would be to begin by saying no to executives who ask for

outlandish requests for millions in options, unjustified bonuses, and outrageous retirement packages. Period.

2nd CEO's need to walk the talk, and be models for all to look up to. We need to end, once and for all, the culture of the Imperial CEO. A value shift is needed in the corner office, with modesty replacing celebrity, teamwork replacing ego, longevity replacing brevity of office, and fair compensation replacing getting rich quick. CEOs need to exhibit restraint, commitment and fortitude. Their vision needs to be broad, not a "winner at all costs" philosophy. Leaders need to remember that they are not monarchs, but rather servants. Companies need to have strong CEOs who can make bold and clear decisions on what they consider to be right and wrong. Not only will the rest of the corporation follow but so will the other industry players.

3rd A culture of transparency needs to be established and promoted. Companies need to become more proactive and communicate with their shareowners. People believe in people. There needs to be more disclosure, more information and more communication.

4th Ethics and social responsibility are courses that must become mandatory in business schools. They must shape the U.S. business conscience. Our schools of business must be principled teachers of right and wrong, and not surrender to moral confusion and relativism.

5th We have seen a few executives led off in handcuffs lately – ImClone's Sam Waksal, the Rigas boys, WorldCom's ex-CFO Scott Sullivan, Enron's Andy Fastow. With the luck of good lawyering (and proof, of course), others will also get carted off to the big house and their ill begotten wealth taken away. We need to jail a lot more of the problem makers.

6th The accounting profession needs to be the continued focus of reform. Auditors' and accountants' first duty is to work for, and serve the shareholders, not help managers fudge the numbers. The creation of the Public Company Accounting Oversight Board is a good first step in the right direction and it needs continued adequate funding and our support to do its job.

7th And lastly, the legal profession also needs to be nudged. The Sarbanes-Oxley Act that creates minimum standards of professional conduct for attorneys is a good move. Nevertheless, the American Bar Association and its members need to take steps to help move my profession to better ethics.

I do believe that ICCR has been, and will continue to be, a force for good in this country. However, ladies and gentlemen, I do offer one word of caution. Steer clear of the pop issues in socially responsible investing. Maintain your discipline on corporate

accountability, fair play, justice and ethics, with transparency and governance as the centerpiece.

If you do this, I predict that you will continue to become a bigger player in the process – and fulfill your promise to encourage more socially and environmentally responsive corporate behavior. And most important, in the final analysis, stay committed to your model: Inspired by faith, committed to action. And in doing this, you will continue to meet the following crucial dictates from Matthew 25, and I quote:

“When the Son of Man comes in his glory, and all the angels with him, then he will sit on the throne of his glory. All the nations will be gathered before him, and he will separate people one from another as a shepherd separates the sheep from the goats, and he will put the sheep at his right hand and the goats at the left. Then the king will say to those at his right hand, Come, you that are blessed by my Father, inherit the kingdom prepared for you from the foundation of the world; for I was hungry and you gave me food, I was thirsty and you gave me something to drink, I was a stranger and you welcomed me, I was naked and you gave me clothing, I was sick and you took care of me, I was in prison and you visited me.” (Matt. 25:31-36)

Thank you, for allowing me to share my views this afternoon on these important topics.