

Male: Why don't we get started after all? \_\_\_\_\_ webcast process. Let me welcome you all. My name is Jack Auspitz. I'm a partner in Morrison & Foerster here in New York and this is an executive forum on unsettled world for \_\_\_\_\_ after Enron and WorldCom settlements. If you are looking for the Mariah Carey concert, that is across the street \_\_\_\_\_. \_\_\_\_\_ try to be entertaining. And this is based \_\_\_\_\_ rather \_\_\_\_\_ discussion \_\_\_\_\_ general questions \_\_\_\_\_ try and keep \_\_\_\_\_ minimum \_\_\_\_\_ try and allow a good amount of time for questions at the end and make this as much of a discussion as we possibly can. My job really is to make the announcement \_\_\_\_\_ panel \_\_\_\_\_. So, in that spirit, I ask everybody to turn off your cell phones and your pagers. If you're in my generation, keep your pacemakers on. There will be a webcast that will start at some point in this and you can get information about that either at Nasdaq.com or MoFo. I still can't say it, on MoFo.com in the Events section. CLE credit will be awarded for this and there are forms that have to be signed \_\_\_\_\_. One's a CLE credit if you haven't done it yet.

Male: And CPE credit if you're an accountant.

Male: There you go. And then there will be evaluation forms at the end. And we ask that you fill those out so we can work on improving the program. There is \_\_\_\_\_ materials that I'm going to ask Bill \_\_\_\_\_. Let me first introduce the speakers for you. I'm a litigation partner at Morrison & Foerster here in New York. Mostly the security litigation enforcement actions, class actions, things of that sort. To my immediate left is my partner Matt D'Amore, also who does securities litigation here in New York and actually is one of the relative few litigators to apply technology and patent litigation with securities litigation \_\_\_\_\_ high tech. To Matt's left is Paul Rouner, who is General Counsel of NASDAQ Insurance Company. And Paul provides management insurance placement and coverage consultation for the NASDAQ Insurance Agency in \_\_\_\_\_. To my right is Bill Sherman, a partner at Morrison & Foerster based in Colorado, Bill is a corporate lawyer who specializes in corporate securities practice. He's been counsel for both underwriters \_\_\_\_\_ connection with more than 200 public offerings \_\_\_\_\_ head of our public company \_\_\_\_\_. And to Bill's right is Roger Raber(?) who is President & CEO of the National Association of Corporate Directors. He's testified in front of Congress \_\_\_\_\_ corporate governance legislation \_\_\_\_\_, provided commentary on Board governance and policies, a variety of policy \_\_\_\_\_ NASDAQ and New York Stock Exchange. \_\_\_\_\_ representing corporate counsel, internal auditors, institutional investors among others. \_\_\_\_\_ often writes for various professional publications. Finally, to Roger's right is Ariana Sadler(?) who is a partner at Goldberg, \_\_\_\_\_. Ariana is also a securities litigator, but on the dark side. She is a plaintiff's lawyer. \_\_\_\_\_ leading plaintiff securities litigator in New York and throughout the nation. And she and I spend a fair amount of time together because I am the liaison counsel \_\_\_\_\_ issuers in the IPO securities

space and Ariana is \_\_\_\_\_ counsel for the plaintiff in that massive 300 case consolidated proceeding that is going on now \_\_\_\_\_.

So, those are the speakers and Bill, do you want to just tell people shortly what's in the book?

Bill: Fine, I'll be happy to. The reason I'm doing this is I'm sort of stuck with -- I got stuck with putting these materials together a couple of months ago. And one of the complaints we've often had at programs such as this when we don't get to all the materials, people say, "Well, what's this in here for?" So I thought I'd just take two or three minutes and let you know what's here and why. Obviously, under tab one is the Agenda that we'll be following today and you will loosely see us following it but we should get to the end of it without any problem. Under tab two is a set of PowerPoint slides, which will actually come quite near the end of the program and during the discussion of what directors can do. So that's tab two.

Tab three is a January 12<sup>th</sup> Morrison & Foerster client alert describing the sort of the watershed event of the WorldCom/Enron settlements involving directors paying money out of their own pockets. And then behind that is a September, 2003 client alert about the best practices and need to demonstrate good faith. Tab four is in fact a copy, for those of you who are interested in hearing the tawdry details, of the WorldCom settlement itself. And this is, I believe Ariana, the actual one. It was the second one that was approved, right? At our last program it had been rejected by the judge. I believe this is the approved one. But Ariana will correct me if I'm wrong about that.

Ariana: I'm pretty confident of the fact given the date on this document.

Bill: This is the good one. This is the good one where the directors had to pay \$4 million more than in the first one, out of their own pocket. The tab number five is the Enron securities litigation settlement. Tab number six is a very interesting article, I believe, a very telling article from the Corporate Board Member Magazine. And when you read through it you will find some, to me, some astounding statistics of responses by incumbent board members on their reaction to the WorldCom/Enron settlement: What they think of it, what they're going to change, what they're not going to change. The bottom line of it is, I'll tell you without reading that you're going to find an astounding number of directors who propose to change nothing in what they do. And with the exception of those who aren't yet on a board, nobody seemed -- not very many seemed to be interested in getting off of boards. I found that just extraordinary. And behind that, there is a Merrill Lynch discussion of protecting directors from claims in case of bankruptcies. And you may have read in The Wall Street Journal how Merrill Lynch has done something for its directors to protect them individually from

liability from getting into their own pockets, in a sense a kind of private insurance fund. And that's behind that yellow tab under tab six.

Tab seven is a NASDAQ fact sheet, describing NASDAQ, describing NASDAQ's business lines. NASDAQ is not just the National Association of Securities Dealers Automated Quotation system. I may be one of the few people who can actually say that. Under tab number eight is the NASDAQ directors' and officers' insurance update and I think you will find in there some fascinating stuff about the state of the market, issues about -- technical issues about coverage. Nothing these days -- and you'll hear this pretty soon from the litigators -- is anything -- nothing is really much more important, other than being diligent, which we'll talk about, than the kind of insurance coverage you have. And to make sure that when you wake up and you find that your company on whose you sit has gone bankrupt or is in trouble, that you don't have an insurance policy because the insurance carrier has rescinded it. I think that is a very important tab with lots of interesting information and important. The National Association of Corporate Directors has a monthly, a February, 2005 monthly piece on liability risk to directors written by Norman Veasey who is the former Chief Justice of the Delaware Chancery Court, am I right? Delaware Supreme Court. And a well respected jurist. And I think you will find that article very good.

And then, of course, the most important stuff is under tab ten, which is all about Morrison & Foerster and the speakers and the biographies. And I guess we will leave it at that and turn back to you, Jack.

Jack: With that, we thought we'd begin by giving you from about a 50,000 foot level, some background on the Enron and WorldCom settlements and why they may be the beginning of a new era and then we'll specify they may not be the beginning of a new era. Matt, do you want to start?

Matt: Sure. I have to say, starting off with a caveat that I was not involved in the Enron or WorldCom settlement. So, starting with that, I do have to say that the WorldCom settlement, when I read about it, took me totally by surprise. When I read the list of directors, one of them that caught my eye was Judith Arene(?), who is a law professor at Georgetown University, somebody I studied in law school. Totally shocked that this was the development that was going to cause somebody whose reputation I had thought was impeccable to pay money out of her own pocket to settle this case. And it totally took me by surprise. I sent the article that was concerning the decision around the office, it engendered a lot comment. So we started to wonder internally whether or not this was really going to be the start of the next wave in these settlements, is this going to be the kind of thing that we're going to be seeing over and over and over again. We did some research. We learned that something similar had happened in the Enron settlement, that directors were also forced to pay out of their own pockets. And,

again, we started to be concerned. So we started to look at these and we said, "Well, all right, let's step back for a minute." Enron and WorldCom we like to think of are anomalies. They're not your everyday case. These were huge, huge companies, \$100 billion in market capitalization that went down in flames suddenly. They went down in bankruptcies. There were huge securities lawsuits that rose out of it. There were criminal fraud elements. And so we took a little bit of comfort from this that maybe this was just -- somebody talked about it in our preparations for today -- sort of a perfect storm. Maybe this was just a confluence of events: High profile companies, a salacious element of criminal fraud, huge bankruptcies, a lot of losses by some major investors, including pension funds. So maybe this was something that was only going to happen once or twice. But we do think that it is something that people need to be prepared for and to think about because securities lawsuits are happening every day and even though cases are not WorldCom or Enron, they're not necessarily on that scale, directors are getting named in these -- directors are sometimes getting named in these cases. And the possibility does exist that some element, whether it's going to be a -- whether it's because insurance fails or because there is a particular agenda on behalf of a plaintiff to seek money from individuals, the possibility remains out there and there are some things we're going to talk about today that you guys can do to protect yourselves.

The other thing that we learned in looking at these settlements, there was a lot of -- the WorldCom litigation led to a lot of not necessarily good law for directors. There were two developments very recently that you may have read about that I wanted to touch on a little bit before we get into the bigger discussion. The first development is there was one director -- well, I guess this is sort of out of order -- but there was one director who held out, a guy named Roberts, I guess, Roberts, who held out, didn't join in the settlement. And he pushed forward with his litigation. And Judge Coat, the smart judge down in the Southern District of New York who is overseeing this litigation, set out some law on what a director's due diligence obligation really is when looking at prospectuses and offerings. And it's not -- I'm not going to get into the details of that decision, but the fact that she had to reach it and the fact that he pushed his case all the way to the end and forced her to reach this judgment is a significant development. He held out hope. It ended up not panning out and he ended up having to settle for, I think, \$5 million out of his own pocket. I think that's where it came out.

The other development, that sort of turns on a legal point, is that you may have heard that this settlement in WorldCom was initially rejected by Judge Coats. It came in from the directors that agreed to pay out of their own pocket. And as Bill alluded to, they ended up having to pay \$4 or \$5 million more than they had originally agreed to, but the reason it was rejected was because Judge Coat believed that it was going to diminish the ability of the plaintiff to recover against the investment banker. She noted that there is this kind of perverse incentive

system in the securities laws right now where if individual directors settle out early, that the plaintiffs will be limited in the amounts that they can recover against other defendants. And what that means for you is that that means that, to the extent that you're ever sued in a litigation, you're likely going to want to get out early, but there are going to be some legal obstacles for you that you'll need to get over in order to actually get that settlement pushed through if you want to try and get out early. \_\_\_\_\_. Ariana? \_\_\_\_\_.

Ariana: Sure. Just touching on the last point, which we can get some more detail a little bit later this morning, the issue about why the WorldCom settlement was originally rejected really brings an issue to the forefront as to how one structures in the context of settlement agreements, the contribution/bar order provisions of that agreement. The PSLRA, the Private Securities Litigation Reform Act, which was enacted in 1995 and became effective in 1996, has specific provisions as to the way in which one must structure a partial settlement. And the provisions that were set forth in the WorldCom agreement, albeit an attempt at creatively putting together a structure that hopefully would not only work for the parties to the settlement, but in addition, for purposes of trying to structure something later for the remaining parties who were outstanding, simply was not going to work in the context of the PSLRA's provisions. And that's what really led Judge Coat to be concerned. In particular, one of the things that the original agreement conceived of was that there should be some limits based upon the financial capacity of the individuals to ultimately pay and there is nothing in the PSLRA that talks about that opportunity. Instead you have to look at proportionate liability and other pieces of it, which we'll get into more detail later.

In terms of what the landscape is currently looking like, these two cases, obviously, were mammoth in size. WorldCom was not only the largest financial restatement in history, but in addition ultimately ended up being the largest bankruptcy in history. Both cases involved circumstances which moved literally at the light of speed. We had announcements in both cases about some kind of mishap which, within two to three months, ended up with a three to four year financial restatement for each of the companies respectively and then ultimately even led to bankruptcy. And that kind of swift movement is something that is very different than many of the cases that we've seen in the past.

I think that the landscape has changed insofar as there are a number of different factors which were affecting the market. Remember that the PSLRA, when enacted, was looking to bring to the forefront of these class actions large institutional investors. When you look at the lead plaintiff motion practice as to who will control a particular litigation in a class action context, under the federal securities laws, we go through a series of motions and steps as to who should control that litigation and who should choose lead counsel. And it's the way that that contest, if you will, is determined is based upon those parties who come forth

with the greatest financial losses. That doesn't mean that necessarily it's the investor with the greatest financial loss, you have to look at who comes forward to pursue actually that kind of participation in the case. That's one piece of it. Now, we're talking about an institutional investor, turns out that approximately 75 percent of recent securities litigations are actually being run in the lead plaintiff capacity by institutional investors. And imagine that those institutional investors now have a large stake in...

Male: Ariana, could you distinguish between institutions that are public entity retirement funds and institutions as in mutual funds because I think there is a big -- I would suggest there's a big difference.

Ariana: Well, I mean we see a large gamut. The institutional investor piece has sort of evolved over time. When we first started out with the PSLRA, it wasn't clear where that was going to move from, whether it was going to be a particularly large individual investor who had lost -- whether it was hundreds of thousands or millions or tens of millions of dollars. We now see pension funds. We also now see hedge funds. And we also now see unions coming forward. Mutual funds, I don't think are really hopping into the current picture as much as some of the other funds, but some of them, and I certainly am not going to take a position on this, but my colleagues to my left will, some of these funds may have some kind of, according to them, political plans as to where they think the litigation should go, where they think the landscape should go. And there is some discussion and some reports, particularly in the press, as to what effect that in particular is having on the landscape and the way in which these cases are progressing.

Male: Let's just pause on that for a second. I think it lends a context \_\_\_\_\_ everybody \_\_\_\_\_. But I think when Congress passed the Reform Act and they had this requirement for a lead plaintiff, they had in mind that this would shift control from very capable players like Ariana's firm to institutions who would try and resolve things in a businesslike fashion. I suspect they thought \_\_\_\_\_ Hathaway, of course they're a defendant now, or other institutions of that type. What they got instead were the same small plaintiffs in many cases that they had before the Reform Act and they got politicians. They got, because of the very big \_\_\_\_\_, that occasionally come into the large case and act as plaintiffs are run by politicians. Allen Heaven(?), Controller of New York, is the lead plaintiff in WorldCom. And I think \_\_\_\_\_ what impact having a politician, many of whom have aspirations of higher office, does to the settlement negotiation. And I think that's what may distinguish WorldCom and maybe Enron and a few other very large cases from the run of the mill securities class action where the plaintiffs, lead plaintiffs, don't have a parallel agenda, perhaps, of political ambition that goes with it.

Male: Paul, do you have a perspective on WorldCom and Enron from an insurance point of view?

Paul: Yeah, that's sort of a basis of my presentation today was to talk a little bit about what happens to insurance in those cases and what do they mean for directors now when they go to look at their insurance \_\_\_\_\_ companies when they buy their insurance. I looked at those cases and some of the other cases that Matt and Ariana will talk about, the Disney-Ovis case and the Emergent Communication case and obviously WorldCom and Enron and sort of figure out what is the common thread here, what does it mean to this changing environment \_\_\_\_\_ directive liability. As you're probably aware, most of these cases settle, like 98 percent or something like that. And they settle typically with insurance dollars. So what happened in these cases? Why did the directors have to pay? Obviously in WorldCom and Enron, as Matt mentioned, there's billions in exposure which isn't typical for every securities case. Obviously, every year there are eight or ten. I think there were ten last year that were monumental sized settlements. But most securities cases are smaller than that. So that's obviously a differentiation \_\_\_\_\_ so much leverage there because of the lost(?) market cap. But I also tried to look at issues that would be more common and more typical of a securities \_\_\_\_\_. And I think there are some. If you look at both cases there is this intense competition for the policy's proceeds. Now WorldCom there was a couple of other issues too. But, for example, in Enron they were running at like \$3 and \$5 million a month for a little while in expense costs, spent about \$100 million in the defense of the case out of these \$350 million in policies. The insurance carriers paid out the money to the court to get out from underneath the competing interests in that case. They ended up paying their limits on that thing, but they handed it over to the bankruptcy court and they sort of \_\_\_\_\_ among the different defendants to sort of settle that because the insurance companies were being pulled in six different directions. So that's sort of part of this sort of new gotcha culture that's out there is that there are six camps now \_\_\_\_\_ defense with big suits. And that's not completely atypical of \_\_\_\_\_ even the smallest \_\_\_\_\_ where you're -- it looks to me as though if you look at Emergent Communications where you've got potential stratification of \_\_\_\_\_ liability issues just on the board, on the outside board. And then you look at the management and the other potential defendants in a securities suit, you've got different interests in the case and they're starting to get more and more bifurcated, in his defense he's got -- where five years ago you had one law firm defending the company, the directors and everyone else, now you might have three, you might have five. At Enron you probably had eight. Sorry, you had a question?

Q: [Inaudible]

Paul: Their insurance was -- they still had insurance left.

Q: [Inaudible]

Paul: In both cases there was. In WorldCom, they'd gone through -- they paid out about the primary, which was AIG had a \$20 million primary on that. There was \$100 million in coverage. So there was about \$80 million left when they settled, left, allegedly \_\_\_\_\_. There's so many interests in it, it's probably all spent from that perspective, but that settlement was interesting. And that's part of my presentation. I kind of put this long discussion of rescission in there and restatement because in that case, the settlement by the excess carriers, they paid -- \_\_\_\_\_ gave them a release and they paid about 50 cents on the dollar for their -- the policy because of the restatement, which I think is -- I mean that's sort of the -- one of the prongs that this sort of new environment in purchasing directors and officers insurance is that the policies you bought five years ago that in the typical securities case, they always send you a 30-page letter when they have a case. But they didn't have as many good issues to get out of paying as they do now. They kind of -- most of the typical policies you buy, sort of the A, B, C company balance sheet and individual protection policies now, the insurance companies have built in a safety valve from their perspective. From your perspective it's kind of an escape hatch.

Male: For the insurer.

Paul: For the insurer, right. I mean it's severability language we talked about a lot in the last three or four years in the directors and officers marketplace. The issue with it as it's evolved is that the language you've got in most policies that provide balance sheet protection has an out in the event of a restatement. It's called rescission and it's not a very high standard. It applies to everybody. And the standard is set out in your state insurance code. I put the Delaware code in your book, which basically the model for everybody's insurance codes. And the standard is if your -- if the stuff, the information you gave the insurance company when you bought the policy was materially wrong, then you can get out of the policy as the insurance company. You can pay back the premiums to the company and walk away, which obviously is not the result you want in a case like Enron. So I think it's a significant issue that needs to be examined by buyers. The reality is that most insurance companies aren't willing to provide a policy that doesn't respond this way on a primary basis that provides balance sheet protection. You've got to look at other potential products or at least an excess product.

Male: Let me clarify, just to follow up on that a little bit. The issue for the WorldCom directors, is that \_\_\_\_\_ talking about the uncertain world a little bit. They faced uncertainty with respect to their insurance carrier. So they didn't know for sure whether that money was going to be available to them or not. And I think as part of this -- does everybody know why there was uncertainty with respect to insurance? Have you actually mentioned that Paul?

Paul: I was trying to. It's a complicated issue. That's sort of where I was going with that. I didn't mean to interrupt you, Matt.

Matt: No, no, no, no, no. There's an assumption in there that perhaps the audience doesn't fully understand why they were in jeopardy.

Paul: Yeah and that's what I was kind of getting at was you had this insurance law that says if the information you gave the insurance company is materially wrong, they can undo the policy. What your policies typically say on a primary basis is -- the first line of it almost on every policy right now is to give up. You sort of acknowledge materiality. So now all it has to be is wrong. So in a restatement you've already acknowledged it's material. Now you're acknowledging it's wrong to the whole public but in your SEC statement. So in every restatement case under most primary policies right now there's an issue where you basically put a big question mark on the policy.

Matt: And that's because you're attaching the financial statements that are the very ones that are found to be need restatement as part of the application so you have an allegedly false application.

Male: There is something you can do about this when you get your insurance \_\_\_\_\_.

Paul: Yeah, yeah, absolutely. I mean that's kind of what \_\_\_\_\_.

Male: \_\_\_\_\_ company's report.

Paul: What I'm talking to companies about now is you can't really go buy these policies necessarily on a primary basis that gives balance sheet protections that are 100 percent necessarily. I talked to some underwriters at AIG and they're willing to do it, but they call it a non-rescindable policy. They give up the right to rescind it. So if they deal with the exclusions but if it's broad, they can maybe knock out individuals, but they're not going to pull the policy for everybody if there's a restatement. But the general appetite among the insurance carriers is not to give that on a primary basis, not to give it where the policy provides balance sheet protection. They are issuing policies, they're selling policies that aren't rescindable and they're usually doing it on an excess basis. And it's worth examining in this context.

Male: Some policies today \_\_\_\_\_ relatively new development is attached to our financial statement we represent that they're true and material in your decision to give us insurance. Then, in that case, as Paul says, if you restate, the insurance company says that it's shocked to discover that there's restating going on and they rescind the policy. Another way you can phrase that in the policy application is to say attached are our financial statements, we believe them, to the best of our

knowledge and information, to be true. And then you have a discussion come restatement time as to what you knew and what you didn't know. And then, as Paul says, a third level is to say in effect I am attaching the company's financial statement. I represent that they're true or I believe that they're true, signed whoever is filling out the application. And then other directors who did not sign the application can say we never made that representation. Even if there is a restatement we're still entitled to our insurance. But, Ariana, I think I cut you off a while ago. Do you want to get back to \_\_\_\_\_.

Ariana: Sure. I was just talking about the landscape and how it has changed from the personal contribution of directors, which I think is something that you in the audience are particularly concerned about. Not only do we have the PSLRA, which changed the landscape for purposes of lead plaintiff motion practice and who is going to control litigation. And again, these are now investors that haven't lost perhaps thousand of dollars or even tens of thousands of dollars; we're talking about people now who have a true vested and often continuing interest in the company, not somebody who has turned over their stock. If you're talking about a pension fund or a union fund, oftentimes they still hold some kind of interest there. So they do care at the end of the day where that money is coming from. And to some extent, yes, they definitely want to hold accountable the individuals who were supposedly on watch. And the watch concept I purposely emphasize because I want you to understand that the PSLRA is only one piece of what has changed the forefront that you're all looking at.

We also now have Mr. Spitzer. Mr. Spitzer is spending a lot of time not only looking at corporate and consumer fraud, but holding individuals accountable. And then moving on even from there, you have the most recent enactment of Sarbanes-Oxley, which clearly has changed the responsibilities of officers and directors and what they need to be doing. There was a period of time where I think many of you were accustomed to having membership on a board be more in the capacity of providing some kind of consulting service or component that perhaps the corporation itself did not have as part of its corporate infrastructure, that by having colleagues from outside that infrastructure there were able to further diversify not only the interests that were being represented, but perhaps if you had somebody sitting on your board who had an engineering background, that brought something else to the table that was helpful. You would have a check but it wasn't a watchdog check, it was to engender discussion, to educate yourselves, educate your clients. And that was very important.

These things that have happened now from the early or mid 1990s through the most recent enactment of Sarbanes-Oxley has completely changed the way in which board members are supposed to be engaged. What is their responsibility? If you look at Sarbanes-Oxley, they are supposed to be serving some kind of watchdog capacity. And as a result, if that is what the perspective is for not only

from a legislation perspective but what the outside world is looking at, then necessarily there is going to be more of an impetus of looking into who should be held accountable and to what extent should we be looking at the individuals who were supposedly on watchdog status at the time.

Male: Yeah, I think we need to have a directive effective here. Go ahead.

Ariana: In addition, yes WorldCom and Enron are unique in terms of their size, in terms of their timing, in terms of the losses and the fact of the bankruptcies that ensued, but those are not the only companies where you're beginning to see officers and directors pay up. I mean, look at the Nortel case. Look at the Global Crossing case. Am I saying that this is necessarily going to be a component of every settlement? No, I don't think it's going to necessarily be -- every settlement is going to involve that. But is there going to be a greater impetus towards that? Yes. And part of it is to impress upon directors to do their job, to do their due diligence, both at the outset before they buy into participating on a board and once you're there make sure that you are educated and that you really are paying attention to what's going on.

Male: Thank you for that preamble. I like to give a perspective from a board, a director sense and knowing that NACD is the only non-profit organization out there focused on corporate boards and we've been in the business for the last 28 years. And let me just start my preamble by saying my first corporate board position was for a savings and loan back in the mid-1980s. That said, I think there were lessons learned at that time and I don't think they were completely adhered to beyond that.

But let me just focus on an issue you brought before. We're seeing the largest turnover in directorships in my 20 years going back to the mid-80s. Why? Because a number of reasons. One is that they don't want to spend the time. We track not only the number of board meetings, everybody knows that from proxy(?) and other ways but we're finding boards now spending over 250 hours in board related issues. And to some people they just thought, "Gee, if I -- if you're going to pay me, how many meetings do I have to attend?" And then they move on. That has changed completely. It's not just an event. And going back to the '80s and '90s, not that far away, again, people perceive their board responsibility as in the area of how many board meetings and make sure I attend those board meetings. But again, it's far beyond that. It's interacting during sessions in between the board meetings with management and a variety of things. That's not, again, terribly complicated there.

Insofar as D&O insurance, again, I remember way back when whereby we saw all these savings and loans being sued not only, again, going after the management but also going after directors. Well, there was that regulatory exclusion of who

was suing you was the regulators. So again, there were certain lessons learned there as well. But going back to today, we are seeing the turnover. And we're seeing the turnover because they don't want to spend the time, directors. They're concerned about their own liability. They look at the culture of the organization. I want to get that said in a few minutes. Or, they're pushed off the board. Again, there's been a whole focus where you didn't have way back when whereby Ariana talking about our boards at that time were you had very passive board members. You had board members who were more accommodating and oftentimes you had a dominant, intimidating CEO and they were not always engaged in what they should be doing as fiduciaries. And frankly, that has changed now. It's changed for the best and for the worst. We're seeing if you ask directors what is the most important issue that came out of -- or practice that came out of the Sarbanes-Oxley, they'll say, "Independence, independence, independence." We now have independent directors because there are no financial, business or family relations. The reality is unintended consequences, we still have independent directors who are passive. What we don't have are independent-minded directors. And that's going to take awhile for that to catch on. What we're seeing now a new set of fiduciaries, not sitting CEOs, not people who sit on eight or nine boards, but we're seeing directors who are engaged. And that's the best way I would put it, that when they're sitting in a boardroom they are going to comment, debate and challenge. And that's why we're seeing with some of the search firms and governance and nominating committees now is that they're looking at that personal characteristic insofar as is this director going to engage, challenge and add some value rather than being passive as it is was before, way back when, whereby you were expected to go along with what was going on.

Number two, you indicated about many of these directors served as consultants. And in fact, they were there mainly to bring business to the organization. And you could see certain merits of that. But if you look at some of the missteps over the last couple of years, you find that many of these directors sitting in the boardroom had no idea how the company operated and no sense of what the industry was all about. And frankly, I can't imagine a director going on a board unless they have that experience or pick it up pretty quickly. I can't understand how you can be a good fiduciary and govern the organization if you don't know how it operates and you don't know enough about the industry.

The other independent consequence of Sarbanes-Oxley is we need to have a financial expert. And again, in my 20 years, that still remains the area for directors so far as lack of competence and understanding. Again, when you say that, "Gee, we have a financial expert," what are the other people, financial dummies? And the reality there is that when people come to NACD and say, "Gee, can you provide us with education as directors and go into governance issues and fiduciary responsibility?" Frankly, we say very focused on make sure

not only do you understand the company and the industry, you need to be financially astute as it relates to financial matters, accounting and related issues. So those are at least a quantum leap in where we were ten or 15 years ago. So we're going from boards that have been more passive to now being much more engaged.

One of the biggest issues we had as a result of Sarbanes-Oxley and it came as result of litigation or a prospective litigation is that -- and I look down to the general counsels -- is that what you were doing to directors because you wanted to make sure you were doing your due diligence, you had management and the general counsel giving the board all the information. When in doubt give it to the board. And we saw board books of 500 pages, the directors plowing through materials that may or may not have been important. Well, the reality is I commend -- because we have a relationship with the Association of Corporate Counsel whereby we do a program in what boards expect from general counsel, we've seen a quantum leap in going from giving all the information because people assume and especially when we debated with the SEC is when they would say, "You're going to have to provide more information, disclosed, fully, accurately," and all that. And I basically said the thing is you've got to give them the right information. And that's a challenge and yet that's the responsibility of management, that's the responsibility of general counsel, that's the responsibility of the board to make sure they're getting the right information. If they want to make a deep dive into the information, so be it.

So those are some of the issues out there that we see a substantial change in the profile and the behavior.

Male: Question in my mind is suppose you \_\_\_\_\_ stuff to anybody, suppose \_\_\_\_\_ says look, I'm \_\_\_\_\_ publicly held company. What do you tell her, do it or not do it?

Male: Well, that's -- what I see corporate McCarthyism. Now, is that \_\_\_\_\_. If there's something wrong in the organization, you look to the directors. I think that's fine. Years ago you didn't know who the directors were. Now the focus is on where were the directors. And as a result of that, have a significant focus, rightly so, on conflict of interest. And you look at NACD and where we get the most questions are in the area of independence and conflict. And we talked before about no family, no business, no \_\_\_\_\_ relationship between the director and the company. But frankly we've gone to a bizarre extent because you'll have people say -- maybe not to me, but this happens frequently whereby you're looking to bring somebody on the board -- again, \_\_\_\_\_ driven by the governance, no doubt about it, the CEO is involved and it's driven by the board. And again, you get somebody who says, "Well, gee, why would you consider this particular person for a directorship when they went to the same high school together and they play golf

every other week?" Now, the reality is that that should not be the reason why the person is not being considered for the board, but that is a mindset that is out there.

Male: \_\_\_\_\_ got a friend who was invited to be on the board, you would advise that person to go on or not \_\_\_\_\_ after WorldCom when your assets are \_\_\_\_\_. \_\_\_\_\_ worth it?

Male: Yes, yeah, I think it's worth it. Are these on? Can people hear in the back? Yes, I think it's worth it. But I'd be -- But I'm afraid of Ariana at the other end of the table because I am on the board of a public company that is not a client of the firm. And I learn an enormous amount serving on that board that helps me advise clients who have board members. And I know what goes on in the back rooms, I can see the internal dynamics of it. And I can tell you that there are ways in which one can -- and we're going to talk about this a little bit later -- one can protect oneself. But the problem that Roger is identifying is that -- and Ariana alluded to -- is that you bring somebody on the board for their technical expertise, you don't need 17 corporate governance experts on your board. You don't need 12 accounting experts on your board. You need enough to keep the system honest and keep it working smoothly. You do need somebody who understands semiconductor fabrication techniques because you're in a competitive industry. You need somebody who knows about sales channels to help advise, because this whole notion of being a watchdog, I think is an additional duty and that the largest duty is unfortunately what the fellow who was the audit committee member of Enron said, he was there to help support management. I don't think that that Professor Emeritus of Accounting from Stanford meant help you cover up what's going on. That person meant I'm here as an expert in accounting to help you figure out the right revenue recognition procedures. That's what that poor guy meant. And I think that the press and the plaintiff had taken that \_\_\_\_\_ and they've been quoted as saying, "I'm here to be your stooge." And that's not what they are. They're not stooges. And why do I sit on this board? Well, the company, I think, is in good shape and I do it with some trepidation, but I think I've learned so much from it that's why I do it. So for me, it ain't the money, I'll tell you that. I mean you might make \$30,000 or \$40,000 a year in board fees and that's about it. And I'll be happy to give up 10 percent or 20 percent of the board fees I've earned in the last couple of years in settlement. That would be a great deal. But I think that a board that wants somebody who really knows about governance and they can turn to me during a board meeting and say, "Tell me what you think about this. Where does this leave us? How would you do it?" And I have some business experience as well, that's the value I bring to that board. I'm not the accounting/financial expert. I'm not the governance expert. I'm there for \_\_\_\_\_ value added to the company and its shareholders.

Ariana: I think I would say in answer to your question, how do you advise somebody who approaches you is I would start with be not afraid but with the caveat that you do

need to do your homework. There are maybe some boards that you would advise your niece or your friend to say, "Sure, that sounds like a good idea," because maybe this person who is approaching you -- the industry that comes to my mind just because it's a simple example is the oil and gas industry. Oil and gas is a really -- it's an industry where there's a lot of expertise. There are people in that industry who know a lot. There are specifics there that your average Joe or Joanna, just they don't know. So to some extent, if this person is approaching you and they have some kind of background there such that to do their homework is an easier study than for instance going into semiconductors, maybe that's an appropriate \_\_\_\_\_ of effort. And do I think that somebody who is approached by just any board should necessarily say yea or nay? No. I think that there are a lot of parameters that have to go into that assessment.

Also, commenting on what Roger had said earlier that we've gone from sort of passive to more aggressively involved, interestingly, because the context has changed, it does affect then the diversity, to some extent of the people that are sitting on your board and the different mindsets that people can bring to the thinking. And the sort of thinking as -- I'll use Bill's terminology, out of the box. Sometimes you need thinking out of the box because it moves things along. It lets you think of things from different perspectives to see what the different kinds of consequences might be. Clearly, when you look at WorldCom and Enron, some of the problems there really dealt with passive situations, with red flags that were right there. I mean, I can give you two basic examples from each of those cases and there are far more red flags than just these.

In Enron, you had Fastow who was the CFO of the company. He had structured finance deals involving partnerships which he managed, he managed. I mean, you don't have to be a brain surgeon sitting on a board to ask a couple of quick questions or to do some quick research. It just doesn't take that much. In WorldCom you've got a situation where Ebbers was actually given loans by the company of more than \$400 million, not \$10 million, not \$5 million, not \$100,000. \$400 million. I don't know how you could be sitting there and not realize that at least a question or two might be asked. And does that then suggest that there were other things ongoing which now you need to delve into much further?

You have to -- you cannot think that this is just some kind of glorified seat. You are being asked to engage and participate in the company and there's a fiduciary duty that attaches to that. So to sit there and think that, "Oh yes, there are things ongoing but I'm not really sure what that means, I'm not sure if there's a consequence." Well, part of the duty that you have by sitting in the chair is to ask the question.

Male: Ariana, let me throw a wrench a little bit into this thing. You're right. Again, we're seeing more engaged. You have to challenge more and they have to speak their mind, directors and things of that nature. And then, frankly, director candidates or those who are serving as directors, are doing a lot of due diligence, to make sure that they don't want to serve on a board that has some of the negative characteristics you talked about. But a concern we have is that, okay, we know there are fewer serving CEOs on boards. And yet there are still companies saying, "I want a CEO, I want a CEO." If you're looking for them, they're not available for a variety of reasons. Number two is that -- and I've had debate with some of the large accounting firms. We're not able to get \_\_\_\_\_ to chair audit committees versus \_\_\_\_\_. Now, concerns we have with our members, recognize our members are directors \_\_\_\_\_ outside independent directors is that is there a perception or a reality that because I am "a financial expert" on chair of the audit committee, I apply a liability? Or if, for some reason, there is a merger and acquisition we're considering and we didn't bring an outside independent valuation by the board or there were certain materials out there that even though you did due diligence, you debated, you interacted, you were well-intentioned, again, something you should have been able to have access and known about you didn't have. What I'm getting at is what we perceive and even if you look at the Judge Veasey article and the materials in the tab nine, is a sweeping concern for impact on the duty of care, duty of liability, the fiduciary responsibilities of directors. That's where we see some concern and people holding back.

Male: Question?

Q: I'm on the board of a Fortune 500 company and \_\_\_\_\_ audit committee. And I am not a financial expert. I have an MBA from Harvard but that doesn't \_\_\_\_\_ expert. I am not nearly as concerned as some of the lawyers are here about the exposure we have. I think there's a couple of major things that directors have to worry about. Number one, if I take Ariana's point, I believe that in the cases we've talked about WorldCom and Enron, if you asked enough questions, you would not necessarily have figured out exactly what was going on, but I do know that if you ask enough questions, you would have known that something doesn't add up. And I think that's all most directors are expected(?) to do. We are not experts on everything. And a crook is going to find a way to cover things up. But at least if you'd asked enough questions to Mr. Fastow, you wouldn't have necessarily have figured out what he was doing, but you would have figured out that something didn't make sense, at which point you'd stop everything and say, "We're going to have to dig in, get lawyers," whatever you had to do.

The other point I would like to make is that with Sarbanes-Oxley and everything we've gone through and 404 at the moment, I don't think we should lose site of the fact that we're living in a very competitive world. Just about every board meeting I sit in these days, the word China shows up fairly regularly. We've got

to be a little careful here while we're getting so good at organizing ourselves in the United States that we comply with every single law we can come up with while our competitors, particular in Asia are busy taking over the world or we're going to wake up with a very well-organized legal way to handle things at the board level but unfortunately we won't have any business. And I think we've got to find the balance. And I'd just like to \_\_\_\_\_ with that. Thank you.

Male: For what it's worth, I just came back from giving a series of lectures in China \_\_\_\_\_ security \_\_\_\_\_. And I tried to be as upbeat about it as I could and giving the positive side \_\_\_\_\_. Each time I finished explaining about Sarbanes-Oxley and about US litigation and about insurance issues and how all that works, the first question I got at every single lecture from some Chinese entrepreneur or investment banker was, "Well, in light of that, why should we list our company on NASDAQ, the New York Stock Exchange? Why shouldn't we just list it in London or in Hong Kong or in Shanghai? Why do we need this grief?" And it's a question we're going to be hearing more and more in a global market as foreign companies have choices about where to seek their capital, whether to seek it in New York as they always have done \_\_\_\_\_ banks \_\_\_\_\_. Or whether they're going to turn to less structured and less regulated markets.

Male: I'd like to make a -- respond to something Ariana said. Thanks to Roger for reminding me of her name, Betsy Adkins(?). She went on the HealthSouth board 16 days before the problems turned up. Why haven't the plaintiffs excused her from that litigation? It is an accounting irregularity where more -- where virtually everything under \$5,000 or \$10,000, every expense was capitalized because that was below the materiality threshold that Ernst and Young or PricewaterhouseCooper used. So every expense, \_\_\_\_\_ lunches, got capitalized below the radar. Now how is somebody like Betsy Adkins going to figure that out going in in terms of diligence, number one. And number two, she's there for 16 days. She remains as a defendant. Why? Why don't you put your money where your mouth is and say, those who couldn't have known or by virtue of time or because it was such a clever scheme -- when the auditors can't uncover that, how is Betsy Adkins going to uncover that?

Ariana: I don't have a direct answer for you to that, just insofar as I'm not personally involved in that litigation and I was not part of either the investigation or the pursuit of the litigation.

Male: This is HealthSouth.

Ariana: However, I will say this to you. When a case is started, there are circumstances from which we decide whether there is a strong enough inference to proceed as to whether a particular person should be named as a defendant or not. And then, as most of you, I think, know, thanks to the PSLRA, discovery does not ensue until

after a motion is dismissed, is denied. So there are periods of time where that kind of decision, whether -- there may be people who think, well, given those circumstances she should be off. I don't know enough about that case. I don't know to what extent during those 16 days she sold \$15 or \$25 million worth of stock. I just don't know enough circumstances there. But one of the things I was going to say earlier is that \_\_\_\_\_ response to something that Roger had said \_\_\_\_\_ the reminder for you is remember that the pendulum with respect to litigation and what the ultimate consequence will be for anyone who is serving as a director, officer and is also named as a defendant is determined by how the facts ultimately play out. And if you have somebody, just as the gentleman said in the audience a couple of minutes ago, who has been asking the questions, has been digging in, has shown he or she was not reckless, they were doing something, that's something that you and your counsel or your representatives are going to argue and which is going to probably weigh more in your favor than mine. So that's something that you really have to look at. If you do your duty, then hopefully then that's going to work out for your favor as opposed to just having been named as a defendant and thinking that the ultimate \_\_\_\_\_ is that you're going to be found liable.

Jack: \_\_\_\_\_ hindsight \_\_\_\_\_ we look at after \_\_\_\_\_ blown up, after \_\_\_\_\_. And what \_\_\_\_\_ you and your colleagues are telling these juries is look, you've all seen the forest fire, now why couldn't these directors have seen some \_\_\_\_\_ six months ago \_\_\_\_\_. There is a huge element of second guessing. And even \_\_\_\_\_ ask questions may or may not find the problem. But \_\_\_\_\_ somebody \_\_\_\_\_ after the fact for not \_\_\_\_\_. Let's put it \_\_\_\_\_.

Ariana: Well, wait a minute, Jack because you must made some criticisms towards my end, so I think I'm entitled to respond. I don't think that that is a fully fair statement, that this is simply a matter of the benefit of hindsight. Again, going back to people have to do their due diligence. People have to ask the questions. The fact that things may play out in such a way that it would have been very difficult for anybody to have figured a situation out because this happened to have been sort of some emperor running the show and who kept everything close to the vest, that's something that's going to come out, that's something that we're going to discover, okay? And then that goes into the kinds of liability or the levels of liability which may be imputed or not. So to simply say that it's based upon hindsight, I don't think is fair. These people, unlike the investor who is out there who doesn't sit at a board meeting, who doesn't have access to the kinds of internal reports that are prepared. And remember, when you sit on a board, you get your board packages but you're also allowed to ask for additional material. It's not like there's some limited volume of paper that you're entitled to at that company. Yes, the board package hopefully is going to spark further questions, thinking, etcetera. And if you have specific questions, either about the industry, about a particular department, about a particular line of business, about a

particular product, well by God, you better start asking the questions and you better ask for the backup too because you want to know.

Male: Ariana, it goes back to -- I'm sorry. It goes back to accountability. There's still that perception out there that \_\_\_\_\_ somehow \_\_\_\_\_ inordinate expectations of investors. So that mindset has to be dealt with in that the major responsibility of the board is to \_\_\_\_\_, hire, fire, evaluate, make sure you have the \_\_\_\_\_. And frankly, I believe that a board, if it's uncomfortable -- again, I could give examples whereby I was the last to find out as a director. I found out in the newspaper. The reality is the transparency of the organization is the CEO going to tell me accurately now what are the issues out there or am I going to learn it from somebody else, then be in a position of defending \_\_\_\_\_ at the top is something that's very important that somebody comes into the organization as a new CEO and frankly just saying, "Gee, they didn't tell me. Management didn't tell me." Or, "They told me too late," or, "I didn't know what was going on." I don't think you can use that type of rationale \_\_\_\_\_.

Male: I \_\_\_\_\_ that. \_\_\_\_\_ that is an important \_\_\_\_\_. You're going to second guess. I can come to you and say, I have...one of the great industrial leaders of this country and of the world \_\_\_\_\_ ordinary track record of providing value \_\_\_\_\_ year after year \_\_\_\_\_ of building companies to where they are \_\_\_\_\_ Fortune 10 status, and who is a compelling charismatic \_\_\_\_\_ leader, you want to hire him, his name is Hank Greenburg. You're going to get criticized for that further down the road.

Male: Just don't give a big severance package, please.

Male: Well let's move on, I'm sorry, what's the question?

Male: I think you started this with, if your niece came to you and said should I join a board, before you move on I would just like to hear some commentary about directors compensation, one of the things your niece is going to consider is, is she being paid, and Roger, you identified an enormous \_\_\_\_\_ you referenced a watchdog \_\_\_\_\_. Again, I think everybody \_\_\_\_\_, but so where does comp come into that whole \_\_\_\_\_ remember, you cite in particular WorldCom, part of the reason \_\_\_\_\_ I think was it's as pliable as it was, Ebbers made everybody there very, very wealthy(?). So then there's this tension of okay, so the director sets the \_\_\_\_\_ if you geared up aggressively, which I think it is happening, maybe, I still don't think anywhere near the \_\_\_\_\_ how does that look to the perspective, inside and outside? Investors want diligent directors but it's not because they want to pay them. And then the other thing I'm interested in is the constituent makeup of that, because if a significant percentage of the comp is in stock, which in many ways aligns the directors with the management, aren't you again potentially going

to be accused of feather nesting if things don't go well? And I'm just interested in all the perspective on that.

Male: Well, the stock issues is actually a really important point. One of the things that the courts look at, in terms of whether or not the directors can be \_\_\_\_\_ liable is have they shown intent in terms of participating in this alleged fraud? Sales of the stock are one of the primary ways \_\_\_\_\_ plaintiff get to proceed with their lawsuit by showing the director has sold stock, and therefore profited from whatever malfeasance went on and therefore must have known and must have had \_\_\_\_\_. So the stock component is a big issue. I'm sorry? Right.

Male: \_\_\_\_\_ exactly. But it speaks to whether or not stock should be a big \_\_\_\_\_.

Male: I'll directly answer your question with respect to that. Aggregate compensation in the mix of cash and stock. There is a fallacy around that equity compensation with management aligns the interest of management and shareholders. I don't agree with that when it's options because there is no ownership in options, there's only the potential for gain, and there's a huge imperative to show gain, because that's where you make your money. So I do not believe that options align management with the public shareholder. Secondly, I think it's counterproductive though it may seem intuitive. With respect to director compensation, similarly, if they're options I feel the same way about the directors \_\_\_\_\_ restricted to stock, particularly where there's performance vesting, or time vesting, even the value of that compensation is enhanced by an increased stock \_\_\_\_\_. You want to really disassociate and keep Ariana back on her heels about this, because you don't have any stock element in that compensation. You have cash, you pay them \$250,000 a year and up for their work, not \$50,000 with a chance to make another couple hundred thousand in options, that's the first thing I was saying. And secondly I would say if you took the number of hours that I personally work and some of you are board members, divided into the amount of compensation, I get about \$15 an hour or something like that. Really, my secretary makes vastly more than that. And that's just not inducive or conducive to quality. Do you agree with my observation \_\_\_\_\_ associate equity comp is going to help systemically \_\_\_\_\_.

Ariana: I think that will help, and I actually have a question for Roger, and depending on his answer, I think I have a further elucidating point. You commented that 250 hours are being spent of board related issues, I'm wondering, is that figure since Sarbanes-Oxley, is it partly before Sarbanes-Oxley?

Roger: I came in as CEO in 1999 at that time I started \_\_\_\_\_ looking at how many board meetings or committee meetings, but how many hours, it was 100, 125 hours. And that 250 hours I'm talking about right now, I suspect would be even more next...

Ariana: I mean, the reason I asked that question, is I think as these figures are continuing to be compiled, as we see what kind of impacts Sarbanes-Oxley and 404 are having, and what further commitment is being required, that at least there's going to be further argument for board members to justify some kind of increase in compensation. That necessarily goes hand in hand. And I think that that's probably helpful to all of you, but it's really going to be dictated by the way in which the compensation evolves, the number of hours that are involved. People are going to look at, for instance, if you have one board member who's spending 250 hours and another board member who is spending 15 hours, never comes to a meeting -- one of the comments I made at a previous panel is to some extent we are victims of our own technology nightmare, and what do I mean by that? Probably every one of us here has at least one, two, or three pieces of technology in our pocket or in our briefcase, there's a cell phone, there's a PDA, and gosh knows what else and who knows what's coming. But the fact of the matter is, we try now, instead of being one series of, one piece of the pie, let's say we're talking about \_\_\_\_\_ hour in the day, we no longer are necessarily focused on doing one thing in that one hour. We're trying to do three things in that one hour, because we can do it. We have a cell phone, we have a PDA, we may also have a computer going simultaneously. And I can't tell you how many meetings, and I know every one of you has been in this situation to where a meeting is called and you have at least 25% of the participants saying I can't get there, I'm going to participate by phone. Well guess what, you participated by phone, by my perspective, you participated, did you pay attention? Did you listen? Did you hear what was said? Did you have anything to say? Did you ask any questions. You better be very careful if you're sitting there on a board and you think you're participating by phone, so therefore you're doing your duty, it's not really the same. And we all know, when we really think about it, it's not the same as being there in person and being fully engaged without phones ringing and computers going and secretaries and assistants and colleagues walking in and asking us to do 16 other things.

Male: Let's talk about that for a second. I \_\_\_\_\_ disagree with my partners but there are \_\_\_\_\_. There's a very interesting article that Jack \_\_\_\_\_ after WorldCom, he argues that one of the principal causes of the WorldCom and similar problems was the change \_\_\_\_\_ where they let you exercise your options and sell on the same day and this creates an incentive for directors to \_\_\_\_\_ cash out, frequently large amounts \_\_\_\_\_. \_\_\_\_\_ let's go the other way, pay directors a quarter of a million dollars a year \_\_\_\_\_ and I think they're worth it, what does that do \_\_\_\_\_ that wants to have a half-dozen outside directors, but to write a million and a half bucks cash compensation to non-executive employees is a lot of money. \_\_\_\_\_.

Male: If you want to promote good governance, require a director, when they come on the board, to make an outside purchase of stock. That gets their attention quickly and gets the alignment between director's perception of the company and

shareholders. The concern I have is, again, talking about Ariana's comment about differential, insofar as people spending, directors spending on board-related issues, our concern is that we know that, and looking at compensation data, that the chair, the audit committee is getting more money, whatever way you divvy it up, \_\_\_\_\_ cash equity and so on and you ask these individuals why and some will say well gee, they're spending more time. But other people will say, well, they have higher liability, that's another red flag for us, is again, do you have differential liability on the board?

Male: Let's go back a little bit towards the outline. I'm sorry, another question, yes sir?

Male: I'd like to take you back a second, to the issue \_\_\_\_\_. It's over simplistic to say that all the director has to do is ask questions. I'd like to raise a slightly different assertion of that. In my experience, and I've been on public company boards for the last 15 years ever since I retired, \_\_\_\_\_ my way of life I suppose \_\_\_\_\_, for the last six years, and asking questions is second nature to me. But I ask questions of the management and if your management's any good, if your CEO and CFO can't answer your question in the board meetings, then you need to change your CEO and CFO, right? It's their business, they're working seven days a week, 24 hours on a it, you whistle in for a day and a half once a month, or whatever. And the issue which I see creeping up on us now with the independent directors, is the need to get independent from management answers. So they've come in with a proposal for a M&A transaction, in the past we gave them a hard time, why are we doing this? What's it's going to do to this? We talked to the investment bankers who were advising management. We asked them, we maybe had an independent session with them. And suddenly I see creeping up, well, maybe that was not enough. Maybe we have to go out and obtain our own lawyers, or own investment. This strikes me as a rocky road to hell, and basically you're trying us become sort of secondary management, if you will, for the organization, and we don't have the time, and frankly, we don't have the expertise to do that. That trend frankly scares me.

Male: I think this is a very valid point, I think it's true at the board level, I think it's true at the professional level. More and more you see boards do what independent advisors \_\_\_\_\_. And then you see the professionals becoming in effect \_\_\_\_\_ as part of the investigation of the board or investigation of the company, rather than being the company's defenders. We're seeing this now every time a problem pops up, an audit committee announces it's going to conduct its investigation, it hires its own counsel \_\_\_\_\_. And this is, frankly, wonderful for the \_\_\_\_\_, wonderful for the accounting business, it's been lucrative assignments. But what it does is it turns you, it turns me as a lawyer, from being the defender of my client to being the prosecutor of my client, it's an awkward, difficult decision, it's one the SEC is encouraging very much that companies do and the SEC will \_\_\_\_\_ it's own investigation \_\_\_\_\_. Everything is turned over to the SEC, you must waive

attorney/client privilege, not to get to a settlement \_\_\_\_\_. If you want to talk to us, do an internal investigation, waive privilege, show us the investigation, and then we'll talk. I don't know if that's \_\_\_\_\_, maybe it is, I think Ariana would feel strongly \_\_\_\_\_ because we have a bunch of stuff to cover. \_\_\_\_\_ talk about the role of the plaintiff \_\_\_\_\_.

Male: Jack, before we move on real quick, can I ask a question of Brad and you and maybe Bill and Ariana \_\_\_\_\_. We talked a lot about this sort of \_\_\_\_\_ fiduciary obligation of the board and how it's changed, and understand there's some cases out there that speak to that issue \_\_\_\_\_.

Male: Well actually I've been looking at this from the, been looking at it from the WorldCom perspective, it's come up in terms of due diligence \_\_\_\_\_, it's come up in terms of due diligence \_\_\_\_\_ due diligence obligation in the past, the board has, in terms of defending themselves from these perspective cases. So for example, in WorldCom, the claim against the outside directors was that they participated in these public offerings and in public offerings, whether they're -- at least of the public offerings that occurred in the WorldCom case -- there's a strict liability standard. So this isn't the kind of broad case where I talked about a little while ago, where they actually have to prove some kind of intent on the part of the participants, show some kind of motives, show some kind of knowledge of the underlying fraud. In these strict liability cases, pretty much they need to show a misstatement or error in the prospectus and that creates liability for the company. Now, in WorldCom -- and so WorldCom's a good example -- because in WorldCom, the company's gone. You can't really go after the company under this strict liability standard, They're in bankruptcy, you can't get any money out of them \_\_\_\_\_ insurance company. But there's no corporate \_\_\_\_\_ anymore. You go after the underwriters and they go after the directors. Both the underwriters and the directors have a due diligence defense. If they've shown -- and this is the kind of thing that we've been talking about here in these contexts -- if they've shown that they did, that they conducted a reasonable investigation, and I don't have the standard on the tip of my tongue, but if they've shown that they've conducted essentially a reasonable investigation and looked into the underlying document and exercised due diligence and asked questions of the document, that can be a defense to these \_\_\_\_\_ what would otherwise be a strict liability. There's also a defense where can rely on whether or not experts, auditors or other financial analysts have signed on off on part of these documents. And those are two defenses that the law provides in these strict liability cases like WorldCom. The problem, this is something that a number of you have alluded to, this is something that gets judged only in hindsight, it's only in the, after the company's blown up or the stock has fallen, or the alleged fraud has come to light that the actions are going to be scrutinized. And it makes your job very, very difficult. You have to sort of do what you think is the right thing to do, looking at the facts before you and in light of the legal standards, but at the same time realizing that when the

flashlight is -- when the covers are taken off and the flashlight is shown on things that perhaps have an issue, there's no way you were going to know, no way you could find this, someone is going to look at the facts and try and put those in a light to say yes, they could have known, yes, they should have known, and these are the things they could have or should have done. Does that mean that you've got to hire outside experts every time? I don't know. Does it mean that it looks better if you hire outside experts? Well sure. Is it required as part of due diligence these days? Not yet. Will there be a case coming out that says, well, they could have, they should have? I don't know, unfortunately it's going to depend on the facts of any particular case.

Male: Ariana, how much more difficult does it make your case when there are experts advising the board?

Ariana: Well, I will respond to that, but first I just want to say, I respectfully disagree with Mr. D'Amore when he says that it makes your lives more difficult after the fact. I disagree. If you carry out your duties consistently, I don't think that it makes it any more difficult, it's just consistent. If you ask the questions. If you are diligent. If you pay attention. If you participate. If you educate yourself, there is no sliding scale. There's no different level of balance depending on the timing. It just is what it is. That's what you have to do. And if you do it right, throughout that period of time, including after the fact when a litigation or some kind of misconduct or event that may prompt litigation comes to light, you know you slept well then, you should hopefully be able now, to sleep well again because you have a record that you yourself created as to what your active and aggressive participation was. To worry after the fact, once a case for instance, comes into action, to say, oh well now my actions are going to be scrutinized, if you're worrying that your actions are going to be scrutinized now, I think you should be worried, I do.

Male: I thought I saw a question back there, on the right.

Male: \_\_\_\_\_. Can you hear me now?

Male: Yeah, thank you.

Male: Did you hear the beginning? The probability that directors will now have...

Male: Well let's talk just about that. Did Mr. Hevasi(?) do a good thing or a bad thing when he said, I am not going to settle any case against the directors unless they contribute out of their own pockets and he said, at the outset of the case, while there was still plenty of insurance available.

Ariana: We spoke about this briefly at the beginning, I think that -- I can't answer your question directly as to what the probability across corporate America and

corporate securities type litigation is going to end up looking like. How often is it that that kind of individual contribution is going to be necessitated, or a necessary component, for instance, of the settlement? I will say this to you, I think that a number of factors have led to a far greater focus on it. Certainly the fact that Mr. Hevasi made that representation, once he said it, that was his intent -- and understand, he is the plaintiff, I mean, that bond is the plaintiff, they are the ones who direct us, we give them legal advice and we pursue the litigation as lawyers, but that's the client. Just like you guys represent your clients, we have to represent our clients. Now I forgot to give this particular disclaimer. I am not directly involved in either litigation. My former partner, Bill Lorac(?) is responsible for the Enron litigation, he's the one who is controlling that litigation. And WorldCom is not my firm, it's actually Bernstein-Littlewitz(?). So to give you the specifics on that situation and how that came about, I was not directly involved and I can't say and in addition, even if I were, I'm not sure if I would be fully inclined to say because there are certain communications, obviously, that I would have to protect. But I think that you have somebody there who's in the public eye and who does want to show that once they stepped up to the plate, and decided to pursue this litigation, they were going to take it really seriously and they were going to push really, really hard, okay? Now, when you have somebody who is not only in the public eye, but has some, in my colleagues words, some political positioning, that's who can make a difference and that's not a shocker for all of you when you hear that. And again, you also have funds that continue to have vested financial interest in these companies, in these stocks. So they may necessarily look to some other outlet in which to recruit \_\_\_\_\_. Now remember in Enron, as an example, that the piece that was -- there were different formulas and equations that were applied in each of these cases, for purposes of how much the individuals were going to pay up. In Enron it was supposed to be approximately 10% of the proceeds. Again, I wasn't directly involved in the case, but there are different computations. But in essence, approximately \$100 million of stock sold by the officers and directors, okay, that's a lot of money. They ended up paying \$13 million. So I hear your concern about having to pay up, but they also made a lot of money. And again, these are not the only two cases where this is happening where there's an expectation of not only a finding of individual culpability, but individual contribution, or accountability, using \_\_\_\_\_. I mean, Martha Stewart, that wasn't me, that wasn't my firm on that piece of it, but that's a criminal case. She went to jail. You've got the Nortel case that I mentioned to you before, you also have other pieces of corporate governance litigation, I think Matt was the one we referred to before, the Disney case and what's going on with Mr. Ovis(?) and Mr. Eisner that's something that my firm is directly involved with, we took that case to trial. All of those things are looking for some piece of accountability. To suggest that it's just necessarily part of the plaintiff's security class action bar, that's not it, it's a whole different world out there now. That has to do with the SEC, Mr. Spitzer, legislation, and lawyers who are out there propagating their cases.

- Male: But let me interject and try to answer your question directly about probability. Up until the last couple of years, probably up until Enron/WorldCom, the National Economic Research Associates in White Plains, New York, I think it's NERA, you could go to them and get data, and you will find, I'm going to give you just an approximation, that if you take \$100 that's been paid in liabilities, settlements, judgments, in actions brought involving violations of the securities laws, where directors are implicated, something north of 60% is paid by the insurers, something around 38% was paid by the company and it was point something percent that was ever paid out of the pockets of directors or officers, .6, .7, .8%.
- Male: That included insiders?
- Male: That includes insiders, these are human beings paid something less than 1%, in the aggregate over a very long period of time. The probability of that certainly defines remote. Now, the questions that I wanted -- that Ariana has not been fully candid with you about -- is the dynamics for the payments applied to individual directors in Enron and/or WorldCom, in one or the other and maybe both, as I understand it, the retainer agreement, the contingency fee agreement the plaintiffs counsel had in them bonuses for if you got money out of the directors pocket. And that the question was that is it was a 25% of recovery, or 20% or whatever it might have been, you get an extra bonus five, absolute five, not relative five percent, for getting money out of their pocket. You weren't involved in those two cases, but I've heard that from a number of sources, that creates a probability change that's dramatic I believe, because in the past, I'm not a litigator, but my litigation partners have always told me, the plaintiffs bar or business people, they have some social goals they believe they are pursuing but when their economic interest is aligned with getting money out of the director's and officer's pockets, I would suggest they didn't much care where the dollars came from in the past, they'd get it out of the insurance company and now the insurance companies have taken a bad rap, they've gotten stuck with a lot and the accounting firms have gotten stuck with a lot. But I think that's a C change.
- Male: The law hasn't changed, not a whole lot. We're talking about the economics of this thing. What I usually tell clients when they get sued there are individuals named as they usually are. And they always ask, \_\_\_\_\_. Unless there's a bankruptcy or restatement, it's highly unlikely.
- Ariana: Both of which happened in Enron and WorldCom.
- Male: Both of which happened in Enron and WorldCom. What also happened in Enron and WorldCom is you had this political element of highly publicized case and you don't get politics unless it is a highly publicized case. There's no point issuing the press release that it's a run-in-the-mill securities class action, nobody's going to

pay any attention. So where you see the large pension, New York pension funds, Alabama, California, are in the very big cases and if you are a director in those kind of cases, then the lead plaintiff in my view is acting very much closer to the SEC or a regulator in trying to achieve a social result than it is as a lead(?) plaintiff on behalf of a class of folks who frankly only want to make back some of the money they lost. And I think there is an issue \_\_\_\_\_ I don't know how we ignore that. ...

Male: The law hasn't changed in such a way that it says, no longer shall it be that insurers can cover directors and officers, there hasn't been a change like that. But the law has changed in terms of, and we talked about this with respect to the Sarbanes and otherwise, with respect to spelling out some of the director's obligations, in terms of spelling out some of the things that need to be done and the things that the audit committee is going to be responsible for. Sarbanes also made restatements a lot more likely. Sarbanes has changed the roles of the auditors in these cases into much more, even the usual auditors, they've increased their watchdog role. The auditors are forcing inquiries and restatements like they weren't before. And we've talked about here about how the fact of a restatement can really change the perspective party's position. It's going to change from the insurance company's perspective whether or not they're going to seek rescission. It can create an obvious red flag that plaintiff's lawyers can go after. The restatement is then going to be coupled by, as in Enron and WorldCom, a bankruptcy, it's going to increase the desire to go after people who might be perceived as having some money. So the law hasn't changed in such a way that it's increased the individual liability, but it has changed in such a way that the forces are going to be aligned to push a little bit more towards individuals I think.

Male: How do you reconcile the fact that all the auditor letters now have a claim in them by the auditors that they're not responsible for finding material misstatements, or fraud, or problems \_\_\_\_\_ that's not their job? How do you reconcile \_\_\_\_\_?

Male: Auditors have always -- The question was, how do you reconcile the fact that auditors, in their letters, always point out that they are not responsible for finding material omissions or fraud, that that's not their job, that's what auditors have always said, before Sarbanes and continue to say after Sarbanes, that they do have, however, now heightened responsibility as corporate officers both in terms of certifying financial results and also the internal control \_\_\_\_\_ which is a new development with Sarbanes and, I think, does increase their exposure despite their \_\_\_\_\_. What I was going to say before is, going back to the economics, I think there's a problem when you get one of these high profile cases and you have a \_\_\_\_\_ plaintiff who says my goal, in part, is to get money from the individual defendant. I think those dollars are going to be harder to get than insurance dollars. \_\_\_\_\_ they take a risk, they get a premium, they expect to have to pay from time to time. Individuals, most often, I think, will resist paying out of their

own pocket until the insurance is gone. So if you announce upfront that I have a social goal, I want to send a message to directors, you may be leaving some money on the table, because the dollars you get from the individual will be harder to get than dollars from insurance company if you said, I'll just take all the insurance and then in WorldCom, there was insurance money left. Now, \_\_\_\_\_ a process producing \$6 billion in settlements \_\_\_\_\_ give the WorldCom plaintiffs great credit for that extraordinary result. And I think there's at least a tension when you have these plaintiffs who have social goals and not necessarily the goals of the people who bought stock in a company that can no longer exist and aren't particularly concerned about the corporate \_\_\_\_\_.

Ariana: But remember, I just want to respond to that, and I see the question in the back. Remember too though, the number of parties that were involved in each of these litigations. I mean, one of them, I can't remember if it was Enron or WorldCom at this point, one of them has, I think, 18 directors. You cannot expect in today's world that when there is going to be a partial settlement with directors, it's not necessarily going to be all of them. I mean, we know that Roberts was a hold out. So to say that money is being left on the table and then in a first tranche that plaintiff counsel are looking for some, or the plaintiff in particular, are looking for some payment directly from the directors themselves, I don't think that there's something wrong or unexpected about that. Because the world has changed. I mean, how many cases have you heard about, I mean certainly my colleagues here to the left of me are fully aware of this, where it used to be that in a class action situation, there was one defense counsel, maybe there was a second who was sort of second chairing. Today that's not the case. How many cases have you seen where there could be as many as five, six different defense firms representing different parties. Everybody's after the same insurance money, but meanwhile plaintiffs are looking to recoup what the investors lost. So there is tension there that I do hear what Jack is saying and what Bill is saying, it's not something I haven't heard before, but there are other competing factors which show why there's a further impetus to really look into the pockets of the directors, because some of that money becomes harder to get money, and remember also that the proceeds from an insurance policy are not simply used to pay out on a settlement or a judgment, but in addition they're being used to cover defense costs.

Male: \_\_\_\_\_ one other practical problem. I see the question, just let me finish this up. The plaintiffs and lead plaintiffs now face when they try and settle with directors. And that is, that the suit is against directors, the auditors, law firm, investment bankers, the Reform Act, Ariana keeps quoting the PLSRA, we keep calling the Reform Act, says that the jury at the end of the day has to find the amount of proportionate pull(?) that each defendant bears. Zero to 100%. And that no defendant should be required to pay more than his proportional share. So here's the problem the plaintiffs had in WorldCom. They had these directors, they may

well have been asleep at the switch, but if they don't have deep pockets that the investment bankers do. You're not going to get \$1 billion settlement from the directors, so we settle with the directors for X dollars, including money out of their own pocket, it's going to be a small part of the total loss and the risk you run is that when the case goes to trial, the investment bankers, they try the case against an empty chair. They say it was all the directors fault, they're not here, it was all their fault. And if the jury buys that, then 80% of the liability could fall on the directors, 20% of the bank, then the plaintiffs can only recover 20% of the damages from the bank, no matter how deep their pockets, no matter how great the damage is. That's a problem when you try and to a partial settlement.

Ariana: We're just very cognizant of that issue when we look at a particular case. Just to give you an example, Jack and I are both involved in IPO Securities Litigation and there's been an announcement of the settlement with the issuers in that case, whereas the claims pending against the investment banks are ongoing. We have to make a cost benefit analysis when we go into a partial settlement, as to how is that, what is the fallout going to be at the end of the day? If we assume that a case is going to be tried and there is an empty chair left because of a partial settlement, how is the jury going to react to that and who is ultimately going to be held to blame? Those are risks that we have to face.

Male: In the IPO case is easy because my issuer client \_\_\_\_\_ and therefore has no proportional \_\_\_\_\_.

Ariana: It's amazing how he just continues to say that.

Male: I think one of the problems that we're perceiving here is that this has become a huge risk shifting exercise, post Enron and WorldCom. One of the byproducts is it's raising the cost of doing business by an extraordinary amount.

Male: Absolutely.

Male: And one of the issues I want to go back and question about, the auditors. What is the role of the audit? The management today is being asked to certify that the financials have been prepared in accordance with the GAAP. I always thought that that was the role of your auditors or your accountants to tell you that. So who, I think...

Male: Let me just jump in and just say that I believe that the simple answer to that question is that auditors would not answer that question that way. They would say it is the company's obligation with it's own internal resources to compile, develop, and report its financial results, including all of its footnotes, in accordance with GAAP, done, tie it up with a ribbon, show it to the auditors, and the auditors check it over. I agree that for years the auditors were helping in the

process of compiling and developing the financial statement. Now you're not allowed to go to your auditors and consult with them about revenue recognition, you're supposed to say, 9702 software revenue recognition we come out with this number, do you agree and they say we can't talk to you until you provide the financial statement in its completed form and then we'll look at it, we'll decide whether you're right or wrong.

Male: That's ridiculous.

Male: Huh?

Male: I said that's ridiculous!

Male: I'm telling you, that's exactly what's happening, Matt, exactly. Any CFOs in the audience? You're nodding, yes, you agree with that? Yeah, that's exactly what's happening. They used to be, she would say, \_\_\_\_\_ had a common conspiratorial scheme but the CFO would say, we're just trying to get it done right, and they've got more resources at EY's national office to come tell us, Bill, under 9702 you've got to do this \_\_\_\_\_ this way and you guys don't have the resources, internally, to do that. But the auditors are washing their hands of it, they got a bad rap before the Reform Act, the proportionate liability was put in there, principally to protect the auditors.

Male: That's what you see -- we talked about this earlier -- the outside directors are distancing from you, your professional advisors are distancing from you, your auditors are distancing from you by leaps and bounds as a result of this climate. Yes.

Male: \_\_\_\_\_

Male: Did people hear the question in the back? I guess it was a rhetorical question. What good are auditors if they can't take responsibility for what they help us create? That's a very good question. But if you want to talk about purity, though, lawyers are your advocates. Auditors are not supposed to be your advocate, they're not supposed to help you make decisions. So I guess the answer is -- well, first of all, you said something interesting, which is the SEC got in and approved it. I think it says on the front of your prospectus, it's a criminal violation to say the SEC approved anything, the SEC didn't raised any issues about it because they never looked at it. In other words, it passed muster with the SEC, but what you do is you can get a letter from the Office of Chief Accountant saying this is the way we think we ought to do it and get an OCA letter and I think that you've got trouble with that, Ariana, when the OCA says it's the right way, don't you?

Ariana: It certainly changes the \_\_\_\_\_.

Male: Yeah, that was yes, it would be harder for her.

Male: I want to get one more question and then let you tell people where they can go \_\_\_\_\_.

Female: \_\_\_\_\_. Better? Back to something Ariana was talking about \_\_\_\_\_. Can you hear me now? I'm on several boards where we have very, very, \_\_\_\_\_ discussions about issues \_\_\_\_\_. And then the notes come back and they're kind of cleansed. And I'd like to know when you get into litigation and you have these cleansed notes that don't show a record of challenges the board made to the executive \_\_\_\_\_, how does that all play out...

Male: I'm going to speak to that in my presentation...

Ariana: I'm going to answer first, because she directed \_\_\_\_\_, I do, I love notes. And Bill and I and I presume Jack and I, have differing opinions on this. In a previous panel somebody representing the defense bar commented that one of the better ways to prepare minutes of the board meeting is to really have your concept written down and don't have too much detail about the actual discussion points. Well I suppose that's a lovely way to try to protect the company, but it most certainly doesn't protect you. Because if you were one of the naysayers, if you were one of the people who was asking questions, at the end of the day, if I don't have evidence and the jury doesn't have evidence that you asked questions and you engaged in due diligence, what is it that you have to prove that point? What is it that you have to work in your favor on that due diligence affirmative defense? You don't have much. Clearly, beyond document discovery, we have deposition testimony, etcetera, but I do think that when you're in a situation where you see serious challenges being posed to a company and the board and issues that you're really grappling with, you need some more detail to protect yourself, as a board member. Now there's, again, I recognize there's a tension, you also have a responsibility, you're sitting on the board of a company, you're trying to protect the company \_\_\_\_\_. Let me finish, Jack. You'll note that I am very polite, I am very polite, but I am firm. I recognize that when you're in a situation, for instance, somebody who's a CFO, you're in a situation that you're serving as an officer of the company and so now you're in a situation where you want to protect the company, you want to have notes that show that topics were discussed, that that in essence provides some proof of due diligence, they were discussed, but that's the tension between the company and the directors and it's an even greater tension for somebody who's an outside director who does not have the direct access to information on more of a daily basis than the outside director does. So I do think you have to be careful there.

- Male: I must respectfully disagree with my very polite, but firm friend because when Ariana gets your notes of the meeting, she is not going to read them as your friend. She is your adversary. She is going to probe through them and look for any ambiguity, any problem she can find. We had a case where we represented an English company and they took lots of notes of a particular transaction they were talking about. And while they were taking these notes, they used typical English phrases which were ordinary to them and they referred to their scheme to acquire this other company. Well in England, a scheme is a plan, here it means one thing and one thing only, a scheme to defraud. And the plaintiffs jumped on that note and they pounded and pounded. Every page of notes you have is going to cost a gazillion dollars in legal fees because it has to be produced, it has to be read, it has to be reviewed, it's going to be examined at your deposition. Notes are an expense and almost always a problem. But I want to move on because, I'm sorry, you have one more quick question.
- Female: ...ask my second question. Recently I was involved in a situation in which the board had just really pushed back on something, ultimately the board prevailed, but this is a huge, huge push \_\_\_\_\_. And should boards be hiring their own counsel, because I did not find \_\_\_\_\_ general counsel or the outside corporate counsel would support a board's position.
- Male: That's very much a case by case decision. It obviously, and we talked about this earlier...
- Male: That was the concern that we had with the corporate reforms is that because you saw a clear indication that where appropriate, boards should be able to bring in advisors. Our concern is that everything that was debated, of any significance, they brought an advisor in. In some cases, hired their own staff. We haven't seen that happen in any kind of systemic fashion. But there are some companies out there that basically depend upon outside advice, and frankly, we know that's not a defense again you're the ones that are accountable so I'd be cautious as far as using them, but again, where appropriate, so be it...
- Male: Roger, I do see one place it's become systemic, is in compensation committees and what you will find is that the normal compensation consultant for the company, for the HR department of the company, at least in Silicon Valley, where I come from, I think it is clearly the rule, not the exception, that a third party compensation consultant, responsible only to the comp committee is there to test. For instance, when you look at all the what-ifs in the executive employment contract when somebody leaves, if Carly Fiorina's going to make more in the next year or two from her settlement arrangement with HP than she would have made in salary and bonuses for the next five years as the CEO, I wonder if the compensation committee has ever had that what-if run for them. What happens if he gets run over by a truck, what if they get sick, what if they get fired, what if

they quit? You'd be amazed at the number of parachutes that are out there that are very lucrative, if the CFO just gets tired to the job and quits!

Male: Bill, you're right insofar as bringing in an outside independent director regarding compensation. But also, gets back to, you have to make sure the members of the compensation committee understand compensation elements. It goes back to the audit committee again, we feel the audit committee, from a holistic perspective, are doing quite well and again, professional and understand their responsibility. I'm not so sure with compensation.

Male: \_\_\_\_\_

Male: Excuse me Jack, just before you move on. I had one response to a question we had earlier about whether or not the law is changing. We've heard from defense counsel that, in most respect \_\_\_\_\_ representation, but there is one concerning element, in especially the Ovis case that I looked from an insurance perspective, where this sort of failure to act in good faith issue has gotten past the motion to dismiss. And that's really concerning to me because your insurance statute in every state says you can indemnify your directors and officers and your by-laws and corporate charters speak to this as well, you have to act in good faith. Now we've got an allegation out there where potentially, they're saying you didn't and I \_\_\_\_\_ case might be a real different issue and real much higher profile if they had less insurance than they had. They've got a couple hundred million dollars and Ovis's comp package was about \$140 million. I think if they has \$100 million, you'd be talking about that case a lot more because there's potential you couldn't indemnify it. And you don't want to be in a position where you're approving a comp package and if something goes wrong, God forbid, you end up in the Disney-Ovis situation your company can't pay and you don't have enough D&O to cover the package, if you were found guilty you'd be liable for it. So as far as the laws changing, I see a sort of dangerous precedent there are far as insurability and indemnification. Indemnification is sort of the, if you can, the company will pay your exposure when you act in capacity of director/officer and there's certain times when you can't, your insurance actually defines those \_\_\_\_\_ issues I look at pretty carefully.

Male: I have to tell two quips before I get into -- what I'm going to go into next is some thinking outside the box in terms of what directors can do to protect assets. And you're not going to get a lot of helpful news there, but you'll at least know we thought a lot about these things. And then I'm going to get into some specific references, exactly what you can do to, some takeaways that are not platitudes. But I have to tell the story about taking notes. Remembering back to two instances on the same public offering, where somebody had written in the margin, next to somebody who was the Vice President of Sales, "This guy is a slezoid." And you can imagine, one of the underwriters did, there was a lot of testimony

about what is the meaning of a slezoid? Is that a term of endearment, a term of criticism, etcetera, etcetera. And the other one was where somebody wrote in the margin, next to the MBNA section, "BS." Well, wouldn't you know, that the party who wrote that down was clever enough to say, "Well that was something I meant to talk to Bill Sherman about after the meeting was over." So as I say, if you're going to keep notes, they better be good or you better be imaginative and clever. \_\_\_\_\_ Here we are. This is just a cartoon about thinking outside the box. These slides are under tab two in your material if you wanted to take notes on them. The first one is insuring the new exposure and thinking outside the box, and we're going to get to some of the platitudes later, but what can we do in the area of insurance? I'm hoping that Paul will comment on this. If you've heard discussions of the rescindable insurance policy, that if you file and attach financials the insurance company's going to turn it down because it's fraud in the inception(?) or some theory like that. There are now, I believe, director only, that's called side C coverage, side A is...

Male: A is the individual, C is the \_\_\_\_\_, B is indemnification for ...

Male: Side A coverage, for directory only. But the important thing is non-rescindable unless the director herself or himself is implicated in the misstatement. All those are standard provisions now that are available in insurance policies.

Male: Well they're available, they're not standard in most primary policies, like I said before, but you can get them, sometimes. And you can definitely get them on an excess basis. Policies \_\_\_\_\_ restatement are going to be there.

Male: But if you're an outside director, wouldn't you want to insist, in terms of going in, as your homework, that there is, if possible, a non-rescindable policy, even if it's an extra \$150,000 or \$200,000 a year premium?

Male: Yeah, along the same line.

Male: Yes, for premiums, you always say yes.

Male: Well along the same lines too, if you look at the standard policy and it made sense five years ago, but maybe it doesn't now, it doesn't differentiate between anybody who's covered by it. So you're all going to the same well with the same bucket so you're all sharing it and there's no line in the insurance policy for who gets what and who's first in priority. You can do that if you want to, you can go in and sort of say hey, this piece of the policy pays the directors first and when their obligation is met, then it can pay the management, you can do that, most people haven't, policies typically don't do that. But in the current environment, I think it's something to look at.

Male: Now, I suppose that everybody in this room, our I hope, if you don't, you should have a personal umbrella policy that goes on top of your automobile liability policy. What about personal umbrella policies that often exclude securities act liabilities, personal umbrellas are available to insure your service on a board, it's going to be expensive. And point number, bullet number three talks about who ought to pay it. \_\_\_\_\_ talked about personal umbrella policies.

Male: Yeah, there actually is, I think it's Chubb actually, who's rolled it out through their personal lines, the same person who will sell you car insurance and home insurance has an option to sell you D&O insurance on a personal basis through \_\_\_\_\_ carriers. I wouldn't recommend going to your guy who sells you car insurance to buy D&O insurance, but that's a separate issue. But most of the carriers are, at least they've rolled out products in most cases it'll cover an individual on your board if you want. You can get a policy just for the \_\_\_\_\_ sort of audit committee head that some of you have mentioned you are. You can do that. Not so many companies are doing it because it's, the way it's originally rolled out, it covers you on every board you sat on and then it's like, who's going to pay for it? Individually probably and it didn't sell very well. If you can get each company to buy you a policy \_\_\_\_\_.

Male: I think that, the question for Ariana, do you think Mr., is it Hevasi? What do you think Mr. Hevasi would think of dollars coming from a personal umbrella, as opposed to coming from the personal bank account? You're not going to answer that Ariana? She's thinking, she's politely thinking. I suggest that that might or might not, but ask Jack and Matt, is that personal umbrella insurance policy going to come into evidence or is this one you can keep from the eyes of the litigator?

Male: Well, the plaintiffs are going to find out about it, because if they get past the motion \_\_\_\_\_ we are required to turn over to them all insurance policies and they will read them carefully.

Male: Even owned personally by the director?

Ariana: Yeah, that's part of Rule 26...

Male: As long as it's available to the \_\_\_\_\_. Yes, where it gets useful is if the company goes bankrupt and you may find that the trustee in bankruptcy saying the company's D&O policy is an asset of the bankrupt estate, it's not available to these D&O's, it's just our money, you can't settle with the company's money, that belongs to the estate. Personal umbrella would not \_\_\_\_\_.

Male: Okay, so again, we're just spending a few minutes on outside the box, because when we get to the end, you're going to see there's some hope, some possibilities, but they're going to cost money. The fourth one is one that I saw in referenced in

--- and it's not my imagination -- the Wall Street Journal, it's one of these don't move or I'll shoot policies, in which, the way the Wall Street Journal describes it, the policy in which if a D&O, if money is taken out of the pocket of an outside director, then the whole underlying insurance for the company, upon which a lot of the settlement will be based, the treasure trove for the settlement, goes away, it explodes. In other words, it is playing with \_\_\_\_\_ like mutually assured destruction, playing nuclear warfare with the plaintiff, that if you go and get in the pockets of my outside directors, this insurance policy is rescindable and rescinded, which every way you want to describe it. I don't know if anybody's went into the policy, but it was described by a reputable journal as at least being considered by the carriers, as certainly, odd if not crazy as it sounds. The last one here, number five, is for people like the NACD, or Nasdaq, the New York Stock Exchange to think about, is there any way that one could create a mutual insurance entity for outside directors where there could be some pooling of liability for all outside directors, that's the way, that's the way lawyers have reacted, accounting firms have reacted, they have their self insurance where the law firms get together and form groups to insurance and certainly take the big dollars.

Male: \_\_\_\_\_.

Male: You've had conversations? Maybe it'll go \_\_\_\_\_. Do you have a question?

Male: \_\_\_\_\_.

Male: That's what I'm talking about, an insurance company just for directors.

Male: It doesn't exist. You can buy policies just for them, but so far there isn't a company just for them.

Male: Roger, you were saying the NACD is thinking and talking about that very issue.

Male: The idea's not new. In Aegis, one of the companies that paid out, I think in WorldCom is a company, an insurance company set up by an energy companies that has a really hard time buying D&O about 10, 15 years ago, and they set up their own insurance company, supposedly there for them, it will always \_\_\_\_\_ for energy companies that had a hard time buying. I mean, you could do it, I personally think that there are good products and it's viable market but you're better off not setting up your own capita(?) to do it for D&O, especially now that the market fluctuates so much. And you're going to -- from year to year -- one year you're going to get stuck, the next year you going to have your capita set up and by the time it's set up, the market's cheaper again \_\_\_\_\_. So I'm skeptical of that. I say that with a grain of salt, my brother, that's all he does, he sets up

\_\_\_\_\_. But I think the market for D&O is good enough if you get the right coverage and policies, it's out there right now and it's probably...

Male: Continuing behind...

Ariana: Bill, I just want to, are you going to talk about that Merrill Lynch \_\_\_\_\_?

Male: We have a copy of that in here, but I don't know probably as much about it as you may...

Ariana: I don't know a lot about it either...

Male: Merrill Lynch has developed a product to self insure their outside directors, and it's a derivative instrument of some sort, that they've gone out and off loaded that risk through a derivative instrument and there's an article about it in your materials which I \_\_\_\_\_.

Ariana: It's a very unique approach to providing some kind of insurance. It's different from going to your typical insurance company and having some kind of policy with limits, etcetera. And this is, if you look at the article, and I can't remember if the materials that we are distributing today there were two different pieces that were available. One was an article describing the \_\_\_\_\_ derivative. But another was actually showing what each party in that situation was \_\_\_\_\_, how much \_\_\_\_\_ selling and it's an interesting concept. It's one of the first that I've seen in this industry and how it's ultimately going to bear out, I don't know. I think clearly Merrill Lynch has represented that it is doing that \_\_\_\_\_ protect itself and its employees, but it's not concerned about its current well-being. But I just point it out to you because it's sort of a unique concept as being...

Male: It's under tab six.

Ariana: \_\_\_\_\_ introduced in the market. I don't know to what extent any of you have contemplated, have talked about it, as to whether \_\_\_\_\_.

Male: What's interesting about that too, is that it's been available for awhile to set up a trust. Most states let you set up a trust for D&O. The problem with them is that they haven't ever been cost effective because you've got to alienate the money to an extent that basically you're throwing dollars away you couldn't touch for a long time, it would be 10 or 15 years, typically. And otherwise you couldn't pay claims you otherwise couldn't indemnify, so in you Ovis case, you still didn't have the benefit of it. What this looks like is a potentially cost effective way of doing that.

Male: But it's only two weeks, or three weeks old that it's become public knowledge.

Male: Wouldn't that only pay in a credit event? That wouldn't work in Ovis situation. The company would have to go bankrupt \_\_\_\_\_.

Male: Yeah, that's right.

Ariana: Yes, that's correct.

Male: It's a credit risk. Do you worry about Merrill Lynch? Did you worry about Enron the day before it happened? I don't think the directors did, so I think that's the lesson. Interestingly enough, in Palo Alto when we did this program, I got a lot of questions about this slide, much to my surprise. The homestead. We all know why O.J. Simpson and Buoy Koun(?) went to Florida and moved their assets there, there's absolutely no dollar limit on homesteading, you can buy yourself a \$50 million house down there, take all your assets, put it there, you got to do it before the trouble happens, as I understand it, but nevertheless, it can, well if the trouble happens or the settlement.

Male: Before you're aware that there is a problem. Once you're aware there is a problem, it's too late.

Male: So O.J. must have gone between the criminal case and the civil case. Asset protection trusts, this is very interesting, there are about five states, much as people claim that Delaware is trying to create a safe haven for corporations, there are five or six states, Alaska's one of them, it's sort of an obscure state, where you can put funds in a trust and make them protective against claims, like D&O claims, against bankruptcy claims. I will admonish all, however, that my bankruptcy partners tell me that if a bankruptcy judge ever gets whiff of these, she or he is not going to like it much, they are so far, largely untested. But in theory, they should work.

Male: They are, I believe recognized and carved out in the new bankruptcy act \_\_\_\_\_ . \_\_\_\_\_ of course does carve out a protective assets protection fund.

Male: Intra family gifts. You will see that some people have taken monies and in a community property state they'll gift the director's half of the her community property to other family members to protect it from seizure in D&O cases and bankruptcy cases. Moving assets to preferred jurisdiction is just a euphemism for getting your money offshore. Where did Vesco(?) go, to the Cayman Islands and there's some island out in the Pacific, Jack tells me about.

Male: Actually, Vesco was my client, I got a Christmas card from him in Cuba years ago, but haven't heard from him since.

Male: I thought he was in Costa Rica.

Male: There are a few jurisdictions that hold themselves out as providing very strong protection of assets. \_\_\_\_\_.

Male: Years ago, pensions were better if you incorporated yourself and contracted your services with your personal holding company. We took a look at that as to whether personal and corporation and personal limited liability company would work, we don't think there's much there, we don't think there's much advantage there \_\_\_\_\_ that's at least something you don't have to look for or spend your time worrying about. Legislative initiative, I wouldn't be surprised if you see some federal or state initiative with respect to limiting director's liabilities with creating this, leveling the playing field again and I'm confident that we'll be seeing something coming soon, if there's anymore repeat of the Enron/WorldCom. I don't think there's much sympathy in Congress or the House of Representatives, the Senate or House of Representative, or any state legislator, frankly, for the Enron/World Com situation, but if the run of the mill, non-perfect storm cases get hit, I think you would see it. Yes ma'am?

Female: I have a quick question on the intra family gift, because my understanding is if you make an intra family gift you number one pay gift taxes, number two, you've lost control of the asset.

Male: Yes, you've lost control of the asset, and yes they gift tax, depending upon how much \_\_\_\_\_.

Female: So it could be much costlier than self insurance.

Male: But the whole point of this outside of the box is to let you know we thought about a bunch of this stuff and we see a few areas of opportunity, but not as many as you might hope. So let's go down to what we're really talking about and I'm going to take what I think are generally seen as platitudes and try to give you some specific comments in regard to bullet number one. You've heard people talking about doing the diligence both before you get on the board and during your tenure. What might that diligence be? Well we've heard about taking a look at the company's public filings, etcetera, etcetera. But I don't think that's where you're going to find the good stuff. I think you're going to find the good stuff if the company is covered by sell side research. Read the sell side research analyst's reports for the company whose board you're thinking of joining, or on whose board you are sitting, and see what they have to say about the risk, see what their comments are. Similarly, look at what the competitors of sell side analysts reports. If you're in the auto parts business, find out what the other auto parts companies say about your company's vis-à-vis the other companies, in terms of whether or not they have a good business model, where the risks are. You will

find if there's going to be skepticism shown, it'll be shown early in those sell side analyst reports, in terms of companies whose business is in trouble. And remember, the problem is created when the stock price goes down. You could have sin, after sin, after sin, of corporate governance happening within a company, if the stock price goes up, you'll never have a call from Ariana. You'll never have a call from Elliott Spitzer or Mr. Hevasi. The stock price has to go down. It covers lots and lots of ill. So if the company has good financial prospects going forward, steady earnings, hopefully not based upon fraudulent revenue recognition, you should be in good shape. And then...

Ariana: Bill, I just want to add to that. Number one is actually probably one of the easier points to really help yourself. Years ago when we didn't have the Internet, things were not as easily accessible \_\_\_\_\_ analysts reports. You couldn't easily get them just by virtue of \_\_\_\_\_ customer of that particular company, \_\_\_\_\_ today, all of this information is available publicly and then some. A lot of companies, whether they like to hear this or not, there are chat rooms going on, talking about the companies, things that are going on internally. Employees are out there talking...

Male: Don't listen to chat rooms. You'll die and you'll turn over in your grave six times, 90% of it's BS, and that's not Bill Sherman...

Ariana: And I'm not saying, to be fair to Bill, I'm not saying to listen to them. You have to take them with a grain of salt. But what I'm saying is there's a lot of information out there that is easily accessible. Do a Google search. Talk to some colleagues in the industry. I think that, unlike before, you really -- just as much as -- the level at which you must be compliant with has gone up. There's also more information out there to make that a little bit easier as well.

Male: Let me focus still on the A1 during tenure. Some specifics. You heard Matt talk about Section 11 liability under the 33 Act, the strict liability. You wonder why the under... Do you have a question, I'm sorry. I see you with the microphone.

Q: On chat rooms. People can waste so much time. Shouldn't it be worthwhile \_\_\_\_\_ having one person \_\_\_\_\_.

Male: Shouldn't we have one person look at it? I believe you should but I think it should be somebody on management doing it, perhaps the general counsel or assistant general counsel reviewing it. Someone -- I wouldn't have the CFO doing it. The CFO's got more important things to do and somebody may have caught onto some bad revenue recognition. He's not going to report that to you.

This due diligence defense reliability, do you ever wonder why the underwriters spend all that time asking questions, going through minutia and asking questions of management, meeting privately with the auditors? This is because there is a

diligence defense in this Section 11 33 Act liability which is what the problem was in WorldCom with all these public offerings of security, or at least registered offerings of security. The diligence defense is if you show that you made a reasonable investigation. Now, a couple of things. What would be a reasonable investigation? Think about the cold comfort letters that the auditors get in transaction. Those used to be, when I was a young lawyer, addressed to the members of the board as well. People seem to have forgotten that. The auditors don't like addressing them to the members of the board, but under the rules of comfort letters, it says they are allowed to address them to anybody who faces 34 Act or 33 Act liability akin to what the underwriters would face. Well, that's you guys if you're on the board. You should make sure those get addressed to you. At least you've got the claim that you relied on somebody who was an expert in accounting and auditing with respect to those numbers in the prospectus like backlog that aren't part of the financial statement that is probably the most important number upon the function of which the stock price trades.

Secondly, you've heard this before, read all the drafts. You don't want to read -- you've heard that -- I would say make sure you read the penultimate draft of any filing of a 10K, 10Q, annual report and registration statement. You will probably get it emailed to you and the record will show that you got it. And Ariana's going to say what did you read. And she may -- you probably haven't read it. And she'll say, "How long was it?" "Oh, I don't know." "Was it thick or thin?" "Oh, I don't know." You better have recognized that she is going to be asking you those questions some day and you ought to have a record in your DayTimer, not keeping a copy that says sleazoid in the margin, that said I spent two and a half hours reviewing carefully, thinking about accounting issues, thinking about compensation issues, thinking about the risk factors. Many of your companies, if they don't they should be, have a quarterly meeting at which the management sits and goes through the 10Q disclosure items and does a bottoms up review. They take a couple of hours, typically meet in your boardroom. And if they aren't doing it, they should be. And with the 10K they will meet for sometimes a half a day and just start at the beginning of Regulation SK and SX and just parse right through it to make sure nothing's been missed. Think about participating in those every once in a while, maybe once a year. Sit in on that or listen in on that, notwithstanding what Ariana said, so that you can understand the kinds of questions, the kind of diligence that's being done and make a record that you sat in on and listened to very interesting discussion and informative discussion where people asked lots of questions and got all their questions answered to their satisfaction.

Male: About the third or fourth question, the SEC standard form examination to directors is what materials did you get prior to each board meeting, how much time did you spend reviewing and it's wise to be able to answer prudently as to what you got and that you did read them carefully.

Male: But isn't there a tension here between the keeping records as a diligence effort and then the \_\_\_\_\_. How do you draw that line?

Male: You keep a record in your DayTimer that for two hours on a Sunday afternoon while having an iced tea on your porch you reviewed the 10K in detail and you asked questions of the management the next time you talked to them about any questions you had and they were satisfactorily answered.

Male: But don't write down what the question was?

Male: No. I wouldn't. Ariana would love to have that. That's all you need to know. The next one I don't...I'm being polite. The next one is occasionally \_\_\_\_\_ okay, I'll get through this quickly. Occasionally inquire about the slide shows management's using when they go out on road shows. Do you know what your CFO and your CEO are saying when they go to the Goldman Sachs conference in your business? Have you seen them? Have you had it presented to you? You should have it presented to you at your next board meeting. Those of you who are CEOs and CFOs here, you would do a favor to your directors by letting them see what you're going to say. And you might find there'll be improvements, you might find it getting carved back. Guidance, how many of you have grilled your management and how many management have been grilled by the board about the guidance being given, the assumptions in it? I think it's very important. If backlog isn't the test of how you're going to be doing in the future and your stock price dropping, certainly guidance is. And for those of you who want to know about guidance and correcting a very important SEC enforcement action against SlowServe corporation, S-L-O-W-S-E-R-V-E, which you ought to look at about the timing of guidance and when it should be updated and when it should not be updated without having a public dissemination. Not a topic for this but I just think SlowServe is very important to read with respect to guidance.

I've talked about getting the comfort letters addressed to you. The next one is executive summaries of complicated financing. I wonder how many of the board members of Enron really understood that the house of cards was built on keeping a P1 prime commercial paper rating. I'll be you not many of them did. How many of you are aware of where you are with respect to the covenants in the loan agreement, which can turn long-term debt into short-term debt, demand obligation? How close are you to those covenants?

I've talked about your DayTimer record in keeping what you did generally and keeping it accurate. Board meetings, I don't know of any board meeting now that goes less than a half a day. Most go a full day. Gone is the day of a two or three hour meeting on a Friday afternoon following or preceding golf. Your board meetings ought to show that they are a good half a day to a day long. And if

they're not, I think Ariana's going to challenge you. How could you have reviewed in a quarter all the important things in two hours? Longer committee meetings, I would never want to have a committee meeting showing that it started, that it lasted minutes. I don't think they have to last hours, plural, but I would think the audit committee is going to last a handful of hours, comp committee an hour or two, governance and nominating committing probably an hour or so. None of these -- and in fact, in the minutes I would not say "the meeting started at 8:45 a.m. and adjourned at 9:15 a.m." I would just leave that -- I would leave that for Ariana to try to figure out.

Don't have more than one audit committee financial expert. A number of companies have asked me, "You know, we've got three or four people on the audit committee and even one or two aren't on the audit committee who qualify as an ACFE under SOX. Should we -- what do you think about listing all of them?" I say, "Don't." You're only required to have one. Why expose four or five of them to the liability of being an audit committee financial expert.

Male: \_\_\_\_\_ for them to have some sort of financial competency.

Male: Absolutely, I believe -- I don't think -- but I don't think, Roger, all have to be financially literate. The rule is all audit committee members have to be financially literate. I'm talking about the technical term, title the ACFE, audit committee financial expert, name, Mary Jones, the chair of the audit committee as that person. Or Mary Jones a member of the committee as that person. I talked earlier today about my view that you should pay more cash and less equity, that the connection of aligning stockholder interest with management through options does not accomplish a lot in my view.

Demanding the corporate governance best practices, I don't hold a lot of love in my heart for ISS or \_\_\_\_\_ or the corporate library. But the institutional investors do. And I believe that if you -- that the one thing, as Roger pointed out, is that independence, independence, independence is the watch word. I sit on a board and I attend lots of board meetings where their clients, they see change has come through independent, non-hand-picked board members, non-hand-picked by the CEO and in those sessions where the CEO is not allowed to attend. Compensation committee meetings where the CEO's comp is discussed, the CEO is not allowed to be in the room during those discussions. It is a dramatic C change from discussion of what the compensation package should be and is. And number -- we've talked about number three, if you're in a regulated industry, FDA regulated, you ought to have somebody on that board who understands phase two, phase three clinicals, what it all means, how those samples can be screwed up. That's where you might want to consider extra help with the board. Officers' compensation related party transactions, we've certainly seen it in Disney and we may see it in HP, although maybe a lot of people don't think that the

compensation parachute for Carly Fiorina was large. There are some that are questioning it.

We've talked about the audit and comp committee members being especially diligent in your areas of expertise. I think the reason why audit committee people are generally better suited and a lot more knowledgeable is because they've been CFOs. They've been to business school. They know T-accounting. They've had cost accounting. They've had bonehead accounting. But none of us, I don't know of anybody, who has really -- in business school or elsewhere -- done courses on HR, on compensation theory and philosophy. It's just an area that not many of us touch and it's actually quite an interesting area and quite rich for learning.

Number six is a platitude I will admit. And just recognize where your weaknesses are. But I'll also say that as part of that, there are organizations out there who will provide fraud detection services for a company where the audit committee or board can bring in an outfit and just bring them in regularly and once a year let them tackle one particular area. What's going on in payroll? What's going on in receivables? What's going on in accounts payable? Is there anybody jimmying anything there? You might just have -- it's like an internal audit function but their specialty is fraud detection.

The next slide we've talked about a little bit. That's being proactive. I strongly believe in seeking independent advice. I believe that the audit committee should have, if not somebody who always attends, someone from a named accounting firm -- doesn't have to be the big four and probably shouldn't be one of the big four, but there's lots of second and third tier accounting firms who understand this stuff -- that is your regular resource for discussion when you have a question about whether or not the revenue recognition and the critical accounting policies which are now a critical part of MBNA(?), whether they're being properly analyzed, properly presented and whether there are other alternative methods for accounting for these transactions. So that's -- I strongly believe in that. I've already told you I believe strongly in the area of compensation, that you ought to have someone independent of the person who works with HR.

B2, this is the hot topic these days, board evaluations, committee evaluations. It is a -- it's socially very sensitive because you will find out that Mary or John turn out to be very ill received by their fellow board members. At least Mary and John now know it. And Mary and John can find out it's because they're disruptive, if they fall asleep at a meeting, they come unprepared, they miss half the meetings or they're jerks or they don't know anything about the area they're supposed to know about. This process, I think, will ultimately, although a lot of directors don't like it, will lend -- will create more qualified, more diligent boards and will help you recognize your weaknesses.

We've talked about the D&O insurance and indemnification policies. If you want to protect your assets and protect yourself if you're a board member, you ought to be intimately involved with and hire someone who is an insurance consultant. Talk to Paul. He'll sell you insurance or he'll advise you on insurance in terms of what you ought to be getting, what are the best practices. The full and timely disclosures from management, it really goes back to getting executive summaries of complicated transactions. You ought to be getting your board books not the day of or the day before the board meeting. Five years ago there weren't board books. The board would walk in and find out what the agenda -- the agenda was set by the CEO and you learned about something and you'd go home and figure that was fine. Now the agenda needs to be set by the lead director. If you have chairman and CEO in a combined function, the lead director should be involved in setting that. The board members, when they meet separately and independently, should be telling the lead director, "We want a special program, special presentation about revenue recognition," or about some issue with respect to sexual harassment programs in the company. And if they're going to bring in a complicated financing that gets you no deduction for GAAP but gets you all sorts of tax write-offs, you say, "Hmm, what is this off balance sheet synthetic lease all about?" You know, get somebody to explain that to you. Does it really fly? Will it fly with the SEC? What are the challenges going to be to it?

I talked about retaining outside counsel for the board and other experts. You might want to just have a lawyer or a law firm just on a general retainer. Give them X dollars a year to be there to respond to questions from board members. And if you put it in -- it's like having an executive session at the end of every board meeting. If you have an executive session and you call it and you haven't had one for the last year and a half, the antennae are going to go up, the hairs on the back of the CEO's neck are going to start bristling. But if you do it every time, it's no big deal. You can keep your private comments to that executive session and not worry a CEO that she or he is being undermined. Same thing if you have a regular outside counsel or accountant that you can go to, a comp consultant. If you go to a CEO and you say, "You know, I really need a lawyer to look at something for the board," the CEO is going to go ballistic and want to know what's going on, what's it going to cost me. But if you have a certain number of allocated dollars per year for these functions and let the board spend, indeed Sarbanes-Oxley mandates that you have to do that. \_\_\_\_\_, Sarbanes-Oxley \_\_\_\_\_ NASDAQ listing requirements \_\_\_\_\_.

I've talked about the due diligence, \_\_\_\_\_ your due diligence procedures and that's doing what the underwriters do, doing as much as they do so that you can assert that defense. Anticipating exposure scenarios, look at the risk factors and look at the critical accounting policies. What are you going to do if one of them comes true? What are you going to do if your new 3.1 release of your software product isn't out on time? What kind of strategic and/or tactical plan do you have

in place? Not that you design it if you're a board member, but making sure that there are plans in place to deal with each crisis.

Lastly, be a good record keeper of your time devoted to the board, topics \_\_\_\_\_ the board. But don't record the actual deliberations. Be a minimalist with respect to your board minutes. And a minimalist with respect to the personal notes you take at home.

With that, I'm done and we're right on...

Male: It's nice to have partners who are not only \_\_\_\_\_ but who can talk fast. Thank you all for coming. We really appreciate it. And if anybody has any questions, we're up here...

END