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William C. Van Faasen
Chair, Board of Directors
c/o Sandra Jesse
Executive Vice President and Chief Legal Officer
Blue Cross and Blue Shield of Massachusetts, Inc.
Landmark Center
401 Park Drive
Boston, MA 02215-3326

Dear Chairman Van Faasen:

On or about March 1st of this year, as part of its annual informational filing with the Massachusetts Division of Insurance, Blue Cross and Blue Shield of Massachusetts, Inc. ("BCBS") reported that its former President and Chief Executive Officer, Cleve Killingsworth, received a severance, payable over slightly more than two years, of approximately \$4,260,000.¹ The board of directors of BCBS (the "Board") had reached a decision to terminate him due to the Board's loss of confidence in his performance; however, because unsatisfactory performance did not constitute "Cause" for termination under his employment agreement (the "Agreement"), he received, by settlement agreement, the amount due him as if he had been terminated without cause.

In response, the Office of the Attorney General (AGO), pursuant to its authority under G.L. c. 12, § 8 to "enforce the due application of funds given or appropriated to public charities within the commonwealth and prevent breaches of trust in the administration thereof," commenced this inquiry into the circumstances under which BCBS became obligated to pay such a large severance to an already well compensated executive upon his involuntary departure from the organization.

The AGO inquiry focused on understanding and evaluating the terms of the contract that gave rise to this obligation, the Board's involvement in the approval of those

¹ The severance amount was widely reported as being approximately \$11,000,000; however that amount represented total compensation, not severance. Of total compensation, approximately \$6,234,720 represented what Killingsworth had already earned as of the date of his departure and would have been due him had he left voluntarily. Moreover, approximately \$5,500,000 of the \$6,234,720 represented amounts earned and reported in prior years but not then paid. When paid upon his departure they were again reported – in effect a double counting. This inquiry is focused solely on the amount that was paid or will be paid in excess of amounts already earned as of this departure. That amount is approximately \$4,260,000.



terms, the process utilized by the Board to oversee and evaluate the performance of its chief executive officer, and the circumstances of the termination. In the course of the inquiry, the AGO interviewed BCBS general counsel and its outside employment counsel and reviewed: (i) relevant contractual severance provisions for both Killingsworth and his successor, Andrew Dreyfus, (ii) board and board committee minutes and reports regarding the approval of such contractual provisions, (iii) annual reviews of Killingsworth's performance, and (iv) consultant reports with respect to the foregoing. Finally, to test certain marketplace assumptions utilized by the Board and its advisors, the AGO reviewed severance provisions contained in chief executive officer employment agreements entered into by a representative sampling of other non-profit, charitable health care providers and insurers in Massachusetts.

1.0 Executive Summary

1.1 Findings

For the reasons set forth hereinafter, the AGO has made the following findings.

Severance

- Notwithstanding the concerns set forth hereinafter, the AGO notes that the Board, upon becoming concerned about the CEO's performance, moved swiftly and efficiently to identify the performance issues and to initiate a change.
- Under the Agreement, Killingsworth was contractually entitled to a significant payment upon his termination or non-renewal unless his removal was a result of his intentional misconduct. The Board's dissatisfaction with his performance did not relieve BCBS of the obligation to make a significant payment. Absent intentional misconduct, the Agreement entitled Killingsworth to remain until death, disability, retirement or the obligatory payment of a large severance.
- Similar entitlements are held by the chief executive officer of every health care organization whose employment contract the AGO reviewed; payment may be avoided only if the performance shortfall involves intentional misconduct.
- Severance clauses that operate to protect an executive from the caprice of his or her board have become a standard part of executive compensation; however until actually paid they have not been required to be reported to the AGO. It is the position of the AGO that they diminish board independence, when triggered are costly both in dollars and public perception, and, in most cases, do not sufficiently advance legitimate corporate purposes to merit their scope and pervasive use.

Performance Review Process

- While the AGO cannot conclude that had the Board utilized a more robust performance review process the necessity of removing Killingsworth would have been

averted, it has concluded that the process used to evaluate his performance during his tenure could be improved. During much of his tenure Killingsworth was the Chair of the Board. While the organization appropriately excluded him from his performance related evaluation and decision making process, the AGO does not believe that such actions ever are sufficient to overcome the pervasive impact of a system in which the CEO for all other purposes led both the organization and its Board. Moreover, the process was weakened by the Board's reliance on Killingsworth's self-evaluation as the primary assessment tool and the lack of a systematic means of obtaining input from other sources.

Service on Outside Boards

- At one point during his tenure, Killingsworth served on the boards of 14 organizations other than BCBS. Three of these boards paid him significant compensation for his service, a practice that did not require disclosure in annual filings with the AGO and was not credited against the compensation obligations of BCBS. This practice is not limited to BCBS. The AGO recognizes that external board service may well advance the interests of a charitable organization. Nevertheless, the AGO believes that the position of chief executive officer is an asset of the organization and its use by an executive to leverage additional and external compensation requires strict board oversight. The AGO is concerned that many boards, including the BCBS Board, may not be exercising sufficient oversight of this practice.

BCBS Board Composition

- This report describes concerns regarding Killingsworth's severance, the performance review process of Killingsworth, and his possible use of a corporate asset (his position) to earn additional compensation. Although concerns over severance clauses and outside positions are not unique to BCBS, the AGO believes that the Board needs to re-evaluate the breadth and depth of its subject matter expertise to assure it has the experience and skills necessary to independently perform its oversight responsibilities.

1.2 Actions

The new CEO of BCBS and its Board, as a demonstration of good faith to the community, have decided to rebate or credit the amount of the severance package, \$4.26 million, to BCBS premium payers.²

As a result of conversations between the AGO and BCBS, the Board has decided to improve its oversight capacity, by reexamining its existing Board recruitment and succession plans to better assure a broad portfolio of Board experience and skills. The plan will promote and support both continuity and the consistent infusion of new talents,

² The fact that amount of the rebate or credit is equivalent to the severance should not be interpreted to suggest that either the AGO or the Board believe that no severance amount would have been appropriate under these circumstances.

skills and ideas. To achieve this objective, the Board will consider, without limitation, such options as term limits and a more robust board performance review process.

In addition, the Board has already undertaken several important and significant actions that address concerns described in this report. Specifically:

- To improve the performance review process of its chief executive, beginning with the election of its new CEO in August, 2010 and in a process formalized by the Board on May 19, 2011 the Board substantially amended and strengthened its procedures. Among other changes, it greatly expanded the depth and scope of the review process including obtaining, on a confidential basis, input from senior management. The process has also elevated premium affordability to a major performance objective.
- On their own initiative, the Board and the new President and Chief Executive Officer, Andrew Dreyfus, have negotiated a compensation package that represents a sharp reversal, at least at BCBS, in the otherwise inexorable rise in health care executive compensation. The current compensation arrangement, together with the suspension of director compensation, should enable the Board and the executive team to send a far more consistent and focused message on issues impacting cost and affordability.
- In late 2007, the Board approved an amendment to the Agreement providing for pre-approval of Killingsworth's service on any public company board; however his existing appointments were grandfathered.
- In the summer of 2009, the Board voted to end the practice of combining the roles of chief executive officer and Board chair effective March of 2010, the end of Killingsworth's then current term as Chair. Given the widespread existence of these severance protections, the need to maintain Board independence from and of management is even more compelling.
- In response to more recent concerns expressed by the AGO regarding independent director compensation, in the spring of this year the Board, together with the board of directors of the Fallon Community Health Plan, suspended the practice.

The AGO will also implement, in the spring of 2012 for the calendar year 2011, the following additional actions as part of its previously announced Oversight Project.³

- To assure comprehensive reporting of all aspects of compensation, including these severance arrangements, the AGO will require all senior executive employment agreements to be disclosed as part of the Oversight Project. In addition to requiring

³ See letter dated September 2, 2009 from David Spackman, Chief of the Non-profit Organizations/Public Charities Division to the Massachusetts Hospital Association, BCBS, Harvard Pilgrim Health Care, Tufts Health Plan and Fallon Community Health Plan. The enhanced oversight described therein will be initiated in the spring of 2012 with respect to calendar year 2011 and is hereinafter described as the "Oversight Project."

annual disclosure of these agreements, the AGO will require an explanation of the basis for the protection afforded.

- The AGO previously announced, in connection with its investigation into the compensation of not-for-profit board members, that it will require annual statements from certain Massachusetts based public charities that compensate independent directors explaining, in detail, the basis and rationale for the practice. Those statements, director compensation levels, and AGO evaluations will form the basis of an annual public report on director compensation practices at public charities.⁴

2.0 Statement of Facts

2.1 Killingsworth's History of Service with BCBS

Killingsworth was initially recruited and hired by BCBS in February of 2004 as its chief operating officer ("COO"). Previous to assuming this position, he had served as the president and chief executive officer of Health Alliance Plan, a managed care organization in Michigan, as well as holding senior administrative positions with Blue Cross and Blue Shield of Rochester and Kaiser Foundation Health Plans. The terms of his employment as COO were set forth in an offer letter agreement dated December 3, 2003. Pertinent to our inquiry, while the offer letter agreement did provide severance protection in the event he was terminated without cause, the document did not contain the definition of "Cause" found in the Agreement.

The AGO was advised that Killingsworth was recruited with the expectation he might eventually assume, upon William Van Faasen's resignation, the position of President and Chief Executive Officer. When Van Faasen resigned in the spring of 2005, Killingsworth was selected by the Board to serve as President and CEO (together, "CEO") and entered into the Agreement. Effective January 1, 2008, upon the resignation of Van Faasen from the position of Chair of the Board, Killingsworth was elected to also succeed him in that position. In response to repeated concerns expressed by the AGO regarding the inherent conflict presented by his serving as the chair of the governing body responsible for both providing his oversight and reviewing his performance, in the summer of 2009 the Board voted to not re-elect him to that position when his then current term ended in March of 2010.

In March of 2010, at the request of the Board, Killingsworth resigned and, consistent with the terms of the Agreement, received, in addition to amounts otherwise due him upon severance, a severance package worth approximately \$4,260,000, the amount he would have received had he been terminated without Cause.

⁴ The scope and content of this annual report may be subject to the provisions of recently filed legislation if enacted into law. See, *An Act Regulating Compensation of Board members for Public Charities*, House Docket No. 3687 and Senate Docket No. 1940.

2.2 Pertinent Provisions

2.2.1 Term. The Agreement provided for successive one year terms.⁵ At the end of each term year, it automatically renewed for an additional one year term unless either party affirmatively elected to not renew. There was no limit to the number of successive year terms. The circumstances, however, under which BCBS was entitled to not renew the Agreement, without triggering a right to significant severance benefits, were extraordinarily limited. A Board decision to not renew for any reason other than what amounted to intentional misconduct (defined as “Cause” - see 2.2.2 hereinafter) entitled Killingsworth to significant severance amounts. BCBS was not even entitled to reduce Killingsworth’s base salary without his consent. The Agreement, absent misconduct on his part or the payment of a large severance, assured Killingsworth an indefinite tenure as CEO.

2.2.2 Termination Rights; Definition of Cause. Under the Agreement, BCBS was entitled to terminate or not renew the agreement only for “Cause.” Acts that would constitute Cause were limited to those that involved intentional misconduct.⁶

2.2.3 Severance Rights and Amounts. If the Agreement was terminated or not renewed by BCBS for reasons other than those constituting Cause, Killingsworth was entitled to receive:

- (a) an amount equal to twice his annual base salary then in effect,
- (b) an amount equal to twice his target incentive award under one of the two incentive plans in which he participated (which was at the time of his termination equal to his annual base salary), and
- (c) miscellaneous other benefits including continuation of health and life insurance related costs, as well as outplacement services and financial planning services.

As his annual base salary at the time of termination was approximately \$1.04 million, the aggregated amount under clauses (a) and (b) was \$4,160,000. Aggregate amounts under

⁵ G.L. c. 176A, §26, limits the term of these agreements to three years. It is not clear that such a provision any longer serves a useful public purpose.

⁶ The Agreement defines “Cause” as: “(i) dishonest acts or statements by the [Executive] with respect to the business of the [Corporation]; (ii) willful violation of government regulations applicable to the Corporation or of the Corporation’s policies, including without implication of limitation, the Corporation’s Code of Ethics and Conduct; (iii) the Executive’s commission of or conviction (which shall be deemed to include a plea of no contest) of (A) a felony or (B) any misdemeanor involving moral turpitude, deceit, dishonesty or fraud; or (iv) a material breach by the Executive of any of the Executive’s obligations under this [Agreement], provided that if there is a satisfactory remedy for the breach, the Executive shall receive written notice of the specific facts and bases for the assertion that the Executive has materially breached this Agreement, and, in the event such notice is given, shall not be terminated under the subparagraph (iv) unless the breach has not been remedied by the Executive within thirty (30) days of the Executive’s receipt of said notice.”

(c) are estimated at about \$100,000. The amounts are to be paid over a roughly two year period.

2.2.4 Board Review and Approval. The record clearly reflects that (i) the entire Board approved the Agreement (ii) the entire Board had before it a clear definition of what constituted Cause and what the impact of a termination without Cause would mean, and (iii) outside employment counsel clearly advised the Board that these types of clauses were a standard component of agreements with executives at this level. Based on the AGO's review, the Board's discussions did not focus on (a) purpose of the severance clause, (b) what risks were intended to be addressed by the clause, or (c) what impact it might have on Board independence.

2.3 Severance Protection in the Local Market

At the time the Agreement was approved, the Board was advised by its outside employment counsel and its compensation consultant that severance protections, such as that ultimately given to Killingsworth, were standard and expected within the relevant market. The relevant market was defined by the consultants as national, under the assumption that, at this level, candidates may be drawn from a national pool. In order to test that assumption within the local market, from which the vast majority of Massachusetts health care chief executive officers have been developed and recruited, the AGO reviewed copies of chief executive office employment agreements for a representative sample of local health care providers and insurers.

Without exception all such agreements contained clauses which severely restricted the basis upon which a board could terminate the services of the executive without the payment of a significant penalty. While the exact language differed, all avoided the payment of severance to acts involving some form of intentional misconduct. There were, however, notable differences among them.

- (a) Retention Period. Some retained severance protection only for the first several years, while others maintained that protection for the lifetime of the agreement including all renewals.
- (b) Formula. While all worked off annual base salary, there were significant differences in the multipliers. As an example Killingsworth's agreement had a multiplier of four (two times annual base salary plus two times annual target incentive bonus) while his successor's multiplier is half that (two times annual base salary – but no incentive bonus in the formula). Some were as short as one year base salary, none were greater than four years base salary.
- (c) Benefits. Almost all retained health insurance coverage during the severance period. Beyond that there was a wide variety of items covered including financial, accounting and professional placement assistance.

- (d) Setoffs. Some had a setoff in the event of subsequent employment; while others, such as the Agreement, entitled the terminated executive to collect in full regardless of subsequent employment or income. All contained provisions conditioning receipt on adherence to confidentiality and non-competition obligations.

2.4 Killingsworth Performance Review and Termination

2.4.1 Process

The process utilized by the Board to annually review the performance of Killingsworth and to develop and determine compensation (within the limits imposed by the Agreement) was managed by a committee of the Board, the Performance Review Committee (the "PRC"). The PRC which was comprised of the chair the Human Resource Committee, the chair of the Governance Committee and the Lead Director or, for such periods as Killingsworth was not so serving, the Chair. Killingsworth developed and submitted to the PRC a self evaluation of his past year's performance that reflected the goals set for that year and the actions, activities and accomplishments in achieving those goals. The PRC then distributed the self evaluation to the directors who, in writing or orally, were entitled to comment on the CEO's performance. These comments were summarized by the PRC and shared with Killingsworth. After consulting with its compensation consultant, the PRC would then consider and submit recommendations to the Board for action. No members of management or external contact points were interviewed nor were their impressions sought. While financial performance data was routinely reviewed by the Board and ultimately validated by external audit, with respect to other measures, no outside advisors or consultants were retained for validation purposes. Nowhere in the self evaluation was there a place for noting areas needing improvement nor did Killingsworth disclose any.

2.4.2 Evaluations

Killingsworth's self evaluations were universally positive. Director comments for the years 2005 and 2006 reflected no reservations or concerns and were exceptionally positive. For 2007, 2008 and 2009, some concerns were voiced regarding such issues as premium affordability, senior management transparency, the dual office holding, strategic vision, and, given the economic downturn, economic performance. One director questioned why the self evaluation never contained any negatives as no one person's performance was ever perfect. Nevertheless, even those expressing concerns remained very positive about Killingsworth.

2.4.3 Decision to Terminate

In January of 2010, the process of Killingsworth's annual performance evaluation commenced. Initial comments from Directors were positive, however concerns were expressed regarding financial losses, lack of focus on operational issues, decline in member satisfaction scores, staff morale and the amount of time spent on new initiatives

and possible transactions. Simultaneously, Killingsworth submitted to the PRC a proposal to substantially enhance the financial value of, and his protections under, the Agreement.

In response, the PRC commissioned its compensation consultants, the Hay Group, to review the proposal. The Hay Group reported that Killingsworth was already above the market norm in most categories, above the market norm in the aggregate and, if the proposal was adopted, Killingsworth's overall compensation would be well above the norm. Killingsworth met with selected committee chairs of the Board on February 26th to discuss his proposal. Subsequent to the meeting he withdrew it.

Concern over these events and the executive's focus on his compensation, led the PRC on March 1st to expand the performance review process to include obtaining input from a broader audience. On March 11th, the full Board received a detailed oral report from the PRC and outside employment counsel on the results of their broader inquiry. Outside employment counsel also advised the Board that the shortcomings identified did not rise to the level constituting Cause under the Agreement and that if Killingsworth was terminated he would be entitled to the severance amounts set forth in the Agreement for a without Cause termination. The Board authorized the PRC and outside employment counsel to present Killingsworth with the opportunity to resign and to receive severance benefits in return for commitments regarding non-competition, disparagement and confidentiality. On March 12th, Killingsworth agreed to resign and on March 16th a separation agreement was executed.

3.0 Discussion and Conclusions

3.1 Severance Protections

The amount to which Killingsworth was entitled, were more generous than most, if not all, other health care providers and insurers in the Massachusetts marketplace whose chief executive officer employment agreements the AGO reviewed.⁷ Nevertheless, all such agreements entitled the executive to substantial severance payments upon termination for virtually anything other than intentional misconduct. Several, including BCBS, had open ended terms that operated to entitle the executive, again absent intentional misconduct, to remain in his or her position until death, disability, retirement or the obligatory payment of a large severance.

Historically, such severance clauses were intended to protect a newly hired executive from unique and identifiable initial risks that might exist in accepting a new high profile position. Examples of such risks include relocation, uprooting family, shifting to a new and unfamiliar marketplace, and the uncertainties of an unknown board. None of these risks confronted Killingsworth. Few, if any, confronted any other executive whose employment agreement was reviewed by the AGO.

⁷ It should be noted that in many of these institutions, virtually identical protections, although with shorter periods and smaller payouts, exist for senior managers below the chief executive officer.

Compensation consultants state that these are high profile, high risk and high turnover positions and therefore merit protection against board actions. To the contrary, a review of the leadership of our large hospital systems and health care insurers is more indicative of stability and the AGO doubts any such executives were such reluctant warriors as to require these protections before accepting the position. In fact, Killingsworth accepted the position of COO under risk circumstances for which such protections were originally designed. He was relocating, uprooting and coming to a new board and new marketplace. While he had some level of severance benefits as COO, it was only after he had relocated and become established in Massachusetts and familiar with the Board and the marketplace that those benefits would become payable under any termination scenario other than intentional misconduct. Clearly these contract provisions⁸ are no longer a response to a particular set of unique circumstances, but instead have become a standard part of executive compensation packages that are not required to be reported until, as is the case here, the payment obligation is triggered.

The AGO believes these arrangements have negative impacts far beyond the amount of the payout.

- Concern over the cost, both in dollars and public perception, may cause a board to delay the discipline or removal of an executive whose performance is unsatisfactory. The AGO has been consistent in its insistence on board independence and any arrangements that operate to impede or curb that independence are of concern.
- To the public served by these organizations, generous payments for non-performance made to already well compensated executives are simply another example of excess in the industry, further eroding public confidence in non-profit leadership and further challenging the basis for their charitable status and subsidization.
- The indefinite term of some of these arrangements is particularly troubling. These executives are very well paid, most have lived here for years, many for a lifetime, and their supervising boards are well known to them. For most the position is the culmination of a long and successful career. In such circumstances it is hard for the AGO to find any justification for these protections during even the initial years of a contract, but what amounts to open ended protection against removal in all but the most egregious situations (or upon payment of a large severance) raises concerns regarding effective board oversight of charitable assets.

⁸ It should be emphasized that the severance provisions addressed here are not those associated with changes in control or reorganizations. At this level employment agreements do provide significant severance benefits to executives upon sales, mergers or reorganizations. Such protections are essential to both incentivize individuals to support changes that may negatively impact their jobs and to keep them in those positions during periods in which such changes are being negotiated.

There may well be circumstances in which the recruitment of a new executive involves at least some initial risks to the employee that would be appropriate to address, however the AGO has seen no basis to suggest that this risk needs to be covered for more than several initial years. Absent a foundation significantly better than “everybody else gets it,” these arrangements are simply another form of executive compensation, particularly when they survive for more than an initial period and become a virtual retirement benefit.⁹

To assure comprehensive reporting of all aspects of compensation, including these severance arrangements, commencing in the spring of 2012 for calendar year 2011 the AGO will require all senior executive employment agreements to be disclosed as part of the Oversight Project. In addition to requiring annual disclosure of these agreements, the AGO will require an explanation of the basis for the protection afforded. In providing its explanation, a board may ask the following questions:

- Were there any particular circumstances or risks facing this employee that merited this protection or was this simply a response to the executive’s demand based on the market?
- Was the prevalence of such clauses, standing alone, a sufficient basis to authorize this one?
- If some protection was appropriate, how was the amount and duration determined and justified?
- Was the executive’s insistence on seeking this level of protection from your oversight decisions taken into account in your recruitment decision?
- To what extent might your independence and discretion be impeded by this arrangement?
- Why wasn’t regular compensation sufficient to cover whatever risks are present?
- Was the definition of Cause broad enough to cover significant performance issues?
- What message is being sent the public your organization serves?

In addition, the Board has decided to return, in the form of a rebate or credit, the amount of the severance package to premium payers.

3.2 The Dreyfus Arrangement

This inquiry was not about executive compensation. Nevertheless the current compensation of Dreyfus and the shift it represents is pertinent to aspects of this inquiry, are noteworthy and deserving of attention.

It has been widely reported and acknowledged that his total compensation is significantly below that of his predecessors and below other Blue Cross Blue Shield plans

⁹ In one case a prominent CEO publicly disclosed his intention to retire; nevertheless he ultimately departed with a severance package equivalent to what he would have received had he been terminated without cause.

around the country.¹⁰ His severance amount, should it ever be triggered, is almost 75% lower than Killingsworth's; in part due to his lower annual salary and in part because the formula does not include his annual incentive plan target. This substantial reduction is a significant improvement over that of his predecessors and many of his colleagues and sends a message that cost control begins at the very top and that the company is placing a greater emphasis on cost reduction and affordability.

To be salary competitive, to attract the best and the brightest, is a legitimate objective for a company that owes its beneficiaries a well run and responsible organization. It is an equally important objective of the company to do a far better job of promoting affordability. The industry has had success in the first; our hospitals and insurers are widely respected and highly ranked. To date the industry has been far less successful in the latter. Ultimately it is the governing bodies of our public charities that must balance these sometimes dueling objectives.

3.3 Killingsworth Service on Outside Boards

At one point during his tenure, Killingsworth was serving on 14 boards of directors outside of BCBS. The AGO acknowledges that external board service can be of significant value to the charitable organization. Although the AGO questions whether any one person, particularly one with a full time, high pressure position such as the CEO of BCBS, can carry out the obligations of a director on that many boards, its most significant concern is that three of these boards paid him significant compensation for his service and that he was elected to these boards subsequent to his becoming the CEO. These additional compensation amounts were not required to be disclosed in public reports nor were they credited against the compensation obligations of BCBS.¹¹

This practice is not limited to BCBS.¹² It does, however, raise significant questions regarding whether these chief executive officers are using their position with the charity to leverage appointments to paying boards and, if so, whether their boards are adequately supervising this use of the charity's assets. This potential use of a corporate asset (the position bestowed by the organization) for individual enrichment is a practice that is significant concern to the AGO and will be directly addressed in the Oversight Project.

¹⁰ Dreyfus recently announced that this year he had elected for forgo the bonus to which he was otherwise entitled.

¹¹ The AGO does note that in at least one case, the chief executive officer routinely donated external board director compensation back to the employer.

¹² The AGO is aware that many CEOs have lucrative outside board positions, many, if not most of which, arose after the individual was given the CEO position by the charity. The AGO has not, however, done a study of the various ways such positions are vetted by the respective boards, controls that are placed upon them, or how the external compensation is factored into organizational compensation, if at all. Such an evaluation will be conducted as part of the Oversight Project.

In late 2007, the Board approved an amendment to the Agreement requiring pre-approval of Killingsworth's service on any publicly held corporation board. However, his existing appointments were grandfathered.

3.4 Performance Review of Chief Executive

The need for strong board oversight of the chief executive officer is critical to the success of any charity. Changes in leadership at the top of any organization are traumatic and costly, and the situation is only exacerbated when removal involves the payment of significant severance amounts. While each of the Directors is accomplished in their own field, it is not clear that this Board had, or at this level any board would have, sufficient experience in this arena to conduct the type of extensive review called for without external assistance. Moreover, the data submitted to the Board was uniformly positive raising significant questions regarding the depth and breadth of the self analysis. To paraphrase one Board commenter: no one is perfect. Moreover, the process was weakened by the Board's reliance on Killingsworth's self-evaluation as the primary assessment tool and the lack of a systematic means of obtaining input from other sources. Finally, anytime a chief executive officer serves as the chair of the board ultimately responsible for reviewing his or her performance, the board's conclusions will inevitably be tainted no matter how careful, which was the case here, it is to exclude the CEO from its deliberations.

The Board has already acknowledged that the performance review process could be improved. It has moved expeditiously to strengthen the process by, among other things, seeking input from a wider audience. It also greatly expanded the depth and scope of the review process including obtaining, on a confidential basis, input from additional sources. The process has also elevated premium affordability to a major performance objective.

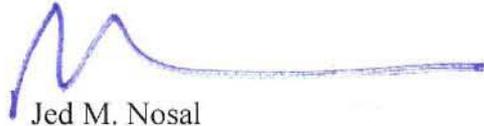
3.5 BCBS Board Performance

This report describes concerns regarding severance, oversight of outside board services, and the performance review process. This report also acknowledges that, despite these concerns, once it lost confidence in the CEO's leadership the Board moved swiftly to address the situation.

The AGO believes that the Board needs to review its portfolio of skills and experience to assure that it has the right mix and balance of resources necessary and appropriate to provide effective oversight. In response the Board will reexamine its existing Board recruitment and succession plans. By matching Board skills with the relevant industry, its capacity to exercise consistent and knowledgeable oversight should be enhanced.

Thank you for your attention and cooperation throughout this inquiry.

Sincerely,

A handwritten signature in blue ink, consisting of a stylized 'J' followed by a series of loops and a long horizontal tail.

Jed M. Nosal
Assistant Attorney General
Chief, Business and Labor Bureau