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**MICHELE B. LEDERBERG, ESQ.**

September 19, 2005

SEP 23 2005

Ms. Michele Lederberg  
General Counsel  
Blue Cross & Blue Shield of Rhode Island  
444 Westminster Street  
Providence, RI 02903-3279

Dear Michele:

This letter outlines the background of our recommendation to BCBSRI in 2000 to pay your directors, as well as information which continues to support our point of view that you will have a stronger board by doing so.

## Background

In April of 2000 you engaged Spencer Stuart to assist you in taking a comprehensive look at the governance of Blue Cross & Blue Shield of Rhode Island. At that time you and the Board had made a commitment to developing a governance structure that would support the organization in the future and that would reflect governance best practices, as followed by other high performing organizations. Our work included interviewing all members of your board (at that time, 36) and preparing a board evaluation, providing an update to the board on best practices in governance, and making recommendations to the board on how it could improve its overall effectiveness as a governing body.

At its annual strategic meeting in October of 2000, the board approved 15 recommendations to be implemented over a period of time. Four of the fifteen recommendations were referred to the Board's Executive Committee for further planning, prior to implementation. Development of a plan to compensate the board was one of these four. At a subsequent meeting, the full Board approved a compensation plan to be implemented effective July 1, 2001.

## Rationale

At the time these recommendations were discussed with the Board, we shared data from a number of different sources regarding director compensation among public and not-for-profit companies. In the 1997 survey done by Blue Cross and Blue Shield Association (BCBSA) on Compensation and Benefits for Blue Cross and Blue Shield Licensee Outside Board Members, it was reported that 89.3% of the main operating companies reporting paid some sort of cash compensation to their board members. The average annual compensation in 1996 was \$16,120 for board members and \$27,598 for board chairs.

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This compensation was up 28% from the level in 1995 and 61% from 1993. Our point was that the majority of Blue Cross and Blue Shield organizations paid board members and the amount being paid was increasing rather significantly on an annual basis.

We also shared a study on ten companies with headquarters in Massachusetts and Rhode Island showing an average annual retainer for board members of \$45,739.

Other studies done annually by Spencer Stuart of public companies support the rationale that highly effective boards require time and commitment from independent directors. These directors are paid for their time and the liability they assume by serving as directors.

The circumstances surrounding your board at the time of the decision to compensate directors provided further rationale for doing so:

- The board size was reduced from 36 to 15, thus putting additional responsibility on each director.
- New committee charters were developed to focus, and in many cases expand, the work of the board committees.
- Director attendance requirements were put in place.
- An active recruitment plan was developed to attract new directors with business experience and specific skills to the board.

Subsequent to your July, 2001 decision, we shared with you a study done by the National Association of Corporate Directors (NACD) for 2002-2003 on Director Compensation (based on proxies filed between 9/1/001 and 8/31/02). The foreword includes statements that are very reflective of the U.S. governance environment then, and even more so today:

“Today, however, interest in director pay is widespread. A renewed focus on corporate governance has resulted in legislative and regulatory actions that affect the roles, responsibilities, and potential liability of directors-particularly in terms of their oversight of audit and compensation issues. It will be necessary to adapt board pay programs to reflect the *increased time and effort* that will be required....The growth curve (in director pay) is likely to sharpen again, however, as boards attempt to pay directors adequately for their time and effort. Recent changes in the corporate governance landscape are increasing the responsibilities and time requirements of directors, with two likely results: Directors will sit on fewer boards and get paid more per board.”

The NACD study included 1166 companies in 25 industries. 6 healthcare companies of comparable size to Blue Cross and Blue Shield Rhode Island reported annual cash compensation of \$33,039 (retainer plus meeting fees).

In September 2003 Clark Consulting's Healthcare Group published a study called Board Compensation-an Emerging Trend in Healthcare. The study did an excellent job of

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articulating the issues we believe you face and the facts that influenced your board to establish a compensation program for directors. Here is a brief excerpt from that study:

“Prior to 1990, very few not-for-profit hospitals or health systems compensated directors for board service. Since then, however, a growing number of health care systems and even some hospitals have begun to pay their board members. This emerging trend is driven by the need to upgrade the quality of board leadership to deal with an ever-increasing regulatory burden, and to address the needs of larger, more complex organizations that cover broader market areas.

Compensating directors can be a significant tool to help a board expand the talent pool it needs to effectively govern in today’s healthcare environment. We believe the following issues will lead growing numbers of health care systems and large hospitals to compensate board members:

- A need to balance the demands of effective community representation with effective governance,
- Increasing legal and fiduciary duties of the board and its members, as well as increasing time commitments as boards become smaller;
- Changes in the time needed by directors to be fully informed and effective decision makers;
- Requirements for more direct supervision of executives, including successful management of leadership transition events;
- Heightened public focus on board decisions involving corporate assets;
- A desire to convince directors to renew their commitment to the organization and to fully participate and contribute to the board and committee responsibilities;
- A need to overcome the dysfunction of boards that are overwhelmed, frustrated, disoriented, and ineffective;
- The necessity of motivating boards to achieve higher standards of performance in tandem with high performance executive teams.”

We believe studies prior to and subsequent to your board’s decision to institute a compensation program for directors support that decision. We also feel you took a conservative approach by setting an annual retainer of \$10,000 and board and committee fees of \$500 and \$250 respectively. All of these amounts are below all benchmarks we were aware of.

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In August, 2003, more than two years after these amounts were put in place, we consulted with you on increasing the fees to the following:

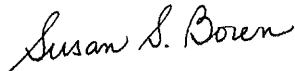
Board Retainer	\$12,500
Committee Chair Retainer	\$15,000
Board Chair Retainer	\$20,000

Board Meeting Fee	\$750
Committee Meeting Fee	\$750

We believe this level of compensation for your directors is justified and is below the appropriate benchmarks for other organizations of your size and complexity. Our work as board recruiters, particularly since Sarbanes-Oxley, has demonstrated to us that it would be very difficult to attract people with the expertise you need without compensating them for their time. It is a competitive marketplace and the number of people in Rhode Island qualified to be directors of a company your size is limited.

We believe events since our original recommendation to you in the summer of 2000 continue to support your decision to compensate your board of directors. I hope this letter clarifies our position.

Best regards,



Susan S. Boren  
Partner,  
Board Services Practice

cc: Amanda Fox  
Partner  
Life Sciences Practice