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**Action/Information Item*****California Student Aid Commission***

Consideration of A Commission Policy, Pursuant to Title 34, Code of Federal Regulations, Section 682.401(b)(16), to Supervise the Compensation of Executives of the Commission's Auxiliary Organization (EDFUND), Including Severance Agreements, Retention Bonuses, Base Salaries and Salary Increases

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**Recommendation:**

Approve the proposed Commission Policy on EdFund Executive Compensation.

**Background**

At the EdFund Board of Directors meeting on April 23, 2008, the Board met in closed session to discuss a proposed "Change-in-Control Severance Agreement" (Agreement) that would have provided benefits to EdFund executives upon the occurrence of a number of circumstances. The Agreement had been drafted by EdFund executives and was not appropriately described in the published agenda. In addition, the materials were provided to Board members in the mid-afternoon on the day before the meeting date. The president of EdFund represented to the Board that he had run the proposal by the Department of Finance's chief operating officer, Fred Klass, who indicated that he was supportive of it and that it was an internal decision of the Board that would not need to be taken to the Commission for action.

The Executive Director reported her concerns about violations of the Bagley-Keene Open Meeting Act (Open Meeting Act) and of potential violations related to the conflict-of-interest provisions of the Fair Political Practices Act (as the presentation of the change-in-control severance agreement was made by the President of EdFund) to the then-chair of the Commission. The then-chair of the Commission made several attempts by telephone inquiries to the chair of the EdFund Board of Directors and through written communications to voice concerns about the actions of the EdFund Board of Directors and executive management.

Against the direction of the Commission, the Executive Committee of the EdFund Board of Directors met in closed session on May 14, 2008, to discuss how to resolve the closed session issue. This was also violation of the Open Meeting Act. The chair of the Commission attempted through a series of communications to communicate the Commission's concerns over the open meeting violations to the Department of Finance's education program management through telephone discussions and written correspondence. Copies of that correspondence are attached as Attachment 1.

In June 2008, the Director of Finance participated in a meeting among the chair of the EdFund Board, the chair of the Finance & Budget Committee of the EdFund Board, EdFund's outside counsel, Nielsen, Merksamer, Parrinello, Mueller & Naylor, LLP, the then-

chair of the Commission, the then-chair of the Commission's Program, Policy and Budget Committee, the Commission's counsel, the Department of Finance's general counsel, and the chief operating officer of the Department of Finance to discuss resolution of the open meeting issues. The outcome of the meeting was the Director of Finance's direction that the Department of Finance would not favor the proposed severance agreements but could accept a retention bonus for a more limited number of the EdFund executives. The Department of Finance has not consulted with the Commission about the need for severance agreements, retention bonuses, or salary increases to retain EdFund executives.

At its August 2008 meeting, the EdFund Board of Directors approved a contract which is to provide salary comparison data to determine a current-year salary adjustment for EdFund management. Members of the Commission participated in the August meeting and requested that the EdFund Board of Directors not proceed with the survey instrument.

Although a member of the EdFund Board questioned the need to proceed with a salary comparison survey given the declining economic environment, Commission staff has been informed that the chair of the EdFund Board's Personnel, Evaluation and Nomination Committee is moving forward with the survey and salary adjustment process.

It is unclear whether the EdFund Board of Directors will act without forwarding their decision forward to the Commission for their approval.

However, given the EdFund Board's persistence in considering severance agreements for its executive management, Commission staff is concerned that a salary adjustment process is not appropriate at this time, particularly under existing economic circumstances. In addition, the salary adjustment process may be perceived as a way to provide a severance or retention bonus under the guise of a salary increase.

## **Discussion**

The United States Department of Education has designated the Commission as the state student loan guarantee agency for California under the Federal Family Education Loan Program (FFEL Program). Federal law authorizes a state student loan guarantee agency to administer the FFEL Program through a nonprofit organization, but explicitly requires the guarantee agency to have and to exercise full authority over, and have accountability for, the nonprofit organization, including the setting of policies for the FFEL Program administration:

In the case of a State loan guarantee program administered by a State government, the program must be administered by a single State agency, or by one or more private nonprofit institutions or organizations under the supervision of a single State agency. For this purpose, "supervision" includes, but is not limited to, setting policies and procedures, and having full responsibility for the operation of the program.

(34 CFR §682.401(b)(16); emphasis added.)

To this end, California law requires the Commission to maintain its responsibility for financial aid program administration and policy leadership if it administers the FFEL Program through an auxiliary organization. (§ 69522(c)(1).)

The Bureau of State Audits has noted: “As a guaranty agency for the FFELP, the CSAC [Commission] has a fiduciary responsibility to the state and federal government, and to the taxpayers to ensure that program funds are spent economically and in accordance with laws and regulations.” (Bureau of State Audits, Investigative Report: Conflicts of Interest and Mismanagement of Federal and State Funds at the California Student Aid Commission, #I960207 (1998).)

The Commission created EdFund as a nonprofit corporation and expressly provided that EdFund was organized, and at all times is to be operated exclusively for the benefit of, to perform the functions of, and to carry out the purposes of the Commission. Payments of salary for EdFund employees, including EdFund executives, come from State money paid by the Commission to EdFund for approved expenditures. The Commission is the sole source of funding by which EdFund pays its employees and any other expenditures.

Thus, EdFund salaries and all other expenditures are paid from State funds.

The Commission currently has no policy establishing the limits of the EdFund Board's authority to establish compensation of EdFund executives without the review and approval of the Commission, except for EdFund executive incentive compensation. The policy on EdFund executive incentive compensation, however, does not involve the full Commission; only the Chair, and is part of the Operating Agreement between the Commission and EdFund.

The circumstances summarily described in the background have established the necessity for the Commission to exercise its authority as the state student loan guarantee agency over the compensation practices of its non-profit auxiliary organization. This is appropriate because State funds are the exclusive source of payment for EdFund compensation to its executives and employees.

Commission staff proposes that the Commission adopt a Commission Policy governing Compensation of EdFund executives, including severance agreements, retention bonuses, base salaries and salary increase. The proposed policy is included with this Tab.

Chapter 182 of the Statutes of 2007 (SB 89) requires the Department of Finance to approve any Commission action affecting the state student loan guarantee program assets before it takes effect, to ensure that the value of those assets is preserved.

The proposed policy preserves the value of those assets by increasing the accountability of the Commission's contractor, EdFund, for the way it spends State funds, and by enhancing responsible oversight of EdFund, as required by federal and state law, in order to ensure that State funds are spent appropriately.

**Responsible Persons:** Ed Emerson, Chief  
Federal Policy and Programs Division

Keri Tippins  
General Counsel

Janet McDuffie, Chief  
Administration and External Affairs Division

# CALIFORNIA STUDENT AID COMMISSION

OFFICE OF THE EXECUTIVE DIRECTOR



May 2, 2008

Sister Sally Furay, Chair  
EDFUND Board of Directors  
1653 Borana Street  
San Diego, CA 92111-6939

Dear Chair Furay:

On April 23, 2008, a closed session meeting of the EDFUND Board of Directors was held to discuss, according to the meeting notice, "Potential sale and related personnel issues." The claimed authority for the closed session meeting was Government Code section 11126(a)(1) and Education Code section 69525(g).

Upon receipt and review of the meeting materials, it was discovered that the purpose of this closed session meeting was to discuss an "Executive Change-in-Control Severance Agreement ("hereinafter "severance agreement") for EDFUND executives in the event that EDFUND is sold as authorized by Senate Bill 89. Discussion and action related to a severance agreement for EDFUND executives is not an appropriate basis for a closed session meeting under California law.

Education Code section 69525(g)(1) provides that EDFUND's "board of directors ... shall conduct its business in public meetings in accordance with the Bagley-Keene Open Meeting Act ... ." The Bagley-Keene Open Meeting Act has very specific restrictions on items that may be considered in closed session. The "personnel exception" cited by the Board of Directors provides: "Nothing in this article shall be construed to prevent a state body from holding closed sessions during a regular or special meeting to consider the appointment, employment, evaluation of performance, or dismissal of a public employee or to hear complaints or charges brought against that employee by another person or employee unless the employee requests a public hearing." There is nothing within this provision which would exempt a discussion of a severance agreement for EDFUND executives from being held in open session. In fact, this would seem to be the type of governmental action that the Bagley-Keene Open Meeting Act was designed to prohibit.

In addition to the exceptions found within the Bagley-Keene Open Meeting Act, EDFUND is permitted to "hold a closed session to consider a matter of proprietary nature the discussion of which would disclose a trade secret or proprietary business information that could potentially cause economic harm to the auxiliary organization ...." (See Educ. Code § 69525(g)(2), emphasis added.) However, there does not appear to be any basis to claim that a severance agreement would be considered a "trade secret"<sup>1</sup> or

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<sup>1</sup> California Civil Code section 3246.1(d) defines "Trade secret" to mean "information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (1) Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."

"proprietary business information"<sup>2</sup> that could cause economic harm to EDFUND for purposes of a permissible closed session meeting under this section.

As a result of the foregoing, it does not appear that there was a legally permissible basis for the severance package discussion to be held in closed session by the Board of Directors. The Commission has consulted with the Office of the Attorney General which concurs that this was an impermissible closed session under Bagley-Keene. The Office of the Attorney General also expressed skepticism over the assertion that a severance agreement for executives was the type of business activity being protected when EDFUND was granted the authority to hold closed session meetings for business items with the potential to cause "economic harm" to EDFUND.

Accordingly, as the Chairperson of the California Student Aid Commission, I am requesting that the May 5, 2008 closed session meeting of the Personnel & Nominations Committee be re-noticed and that all discussion related to the severance agreement be held in an open session meeting. It should be noted that Government Code section 11130.7 makes it a misdemeanor for "each member of a state body who attends a meeting of that body in violation of any provision of [Bagley-Keene] where the member intends to deprive the public of information to which the member knows or has reason to know the public is entitled to ...".

In addition, the Board of Directors may wish to seek legal advice on whether adopting the severance agreement may trigger a violation of the Political Reform Act or other conflict-of-interest laws for any of the EDFUND executive management who may have "participated in the making of" the severance agreement proposal.

Lastly, it is my understanding that any action taken by the Board of Directors with respect to a severance agreement will require approval by an officer of California Student Aid Commission and must be in accordance with Commission policy pursuant to Education Code section 69526(a). The severance agreement will also require the approval of the Director of Finance pursuant to Education Code section 69526(b).

Sincerely,



Dennis J. Galligani  
Chair

CC: Members of the California Student Aid Commission  
Members of the EDFUND Board of Directors  
Mr. Fred Klass, Chief Operating Officer  
Ms. Jeanine Oropeza, Program Budget Manager

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<sup>2</sup> Black's Law Dictionary defines proprietary information as "In trade secret law, information in which the owner has a protectable interest." BLACK'S LAW DICTIONARY (6<sup>th</sup> ed. 1990).

# CALIFORNIA STUDENT AID COMMISSION

OFFICE OF THE EXECUTIVE DIRECTOR



May 9, 2008

Sister Sally Furay, Chair  
EDFUND Board of Directors  
1653 Borana Street  
San Diego, CA 92111-6939

Dear Chair Furay:

Thank you for sharing with me the legal opinion from EDFUND outside counsel, Murphy Austin Adams Schoenfeld LLP, on whether the Change in Control Severance Agreement can be held in closed session in accordance with Government Code section 11126(a)(1) and Education Code section 69525(g). I have shared the legal opinion with the Commission's General Counsel and requested that she provide to me her analysis of the opinion; a copy of that opinion is attached for your consideration.

In summary, the General Counsel is not persuaded by the arguments offered by outside counsel. With respect to the "proprietary" exception found in the Education Code, our General Counsel disagrees that a discussion of severance benefits was contemplated by the Legislature when EDFUND was given the authority to meet in closed session on items of a proprietary nature which would "disclose a trade secret or proprietary business information that could potentially cause economic harm ..." to EDFUND. As you know, executive compensation is already publicly disclosed through the Annual Reports issued by EDFUND and is therefore not proprietary. Accordingly, it seems unlikely that EDFUND could satisfy either the "proprietary" or "economic harm" elements of this provision.

Similarly, case law analyzing the "appointment, employment, evaluation of performance, or dismissal" language has determined that it does not apply to salary and benefits. While admittedly the case mentioned above is referring to the Brown Act governing local agencies, the language is identical to the language found in the Bagley-Keene Open Meeting Act which governs state agencies, boards, commissions and EDFUND.

In enacting the Bagley-Keene Open Meeting Act, California has demonstrated a strong commitment to ensuring that the public has ready access to the workings of public agencies, including the setting of salary and benefits of public employees and the expenditure of state funds. By making EDFUND subject to the provisions of the Bagley-Keene Open Meeting Act, the Legislature has made it clear that EDFUND should conduct itself within the same parameters of other state entities and conduct all meetings in open session unless explicitly granted the authority to do otherwise. The opinion of outside counsel relies heavily on legislative intent and an "uncertainty" on whether salary and benefits falls within either of these exceptions. As a state body, EDFUND should exercise extreme caution when operating in a manner contrary to the statutory constraints explicitly placed on EDFUND when it was created and made subject to the provisions of the Bagley-Keene Open Meeting Act.

Accordingly, as the Chair of the California Student Aid Commission, I am requesting that the May 14, 2008 closed session meeting of the Executive Committee be re-noticed and that all discussion related to the severance agreement be held in an open session meeting. In addition, I am requesting that any discussion of the Change in Control Severance Agreement contemplated for the May 15, 2008 closed session meeting of the Board of Directors be re-noticed and discussed in open session. "Each member of a state body who attends a meeting of that body in violation of any provision of [Bagley-Keene] where the member intends to deprive the public of information to which the member knows or has reason to know the public is entitled to ..." is guilty of a misdemeanor. (See Government Code section 11130.7.)

Once again I would like to reiterate that any action taken by the Board of Directors with respect to a severance agreement will require approval by an officer of the California Student Aid Commission and must be in accordance with Commission policy pursuant to Education Code section 69526(a). The severance agreement will also require the approval of the Director of Finance pursuant to Education Code section 69526(b).

Please let me know if you have any questions.

Sincerely,



Dennis J. Galligani  
Chair

CC: Members of the California Student Aid Commission  
Members of the EDFUND Board of Directors  
Mr. Fred Klass, Chief Operating Officer  
Ms. Jeannie Oropeza, Program Budget Manager



**M E M O**

**DATE:** May 8, 2008

**TO:** Dennis Galligani, Chair

**FROM:** Keri Faseler Tippins  
General Counsel

**SUBJECT:** EDFUND Change in Control Severance Agreement  
Bagley-Keene Open Meeting Act Violations

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Pursuant to your request, I have reviewed the May 1, 2008 Memorandum prepared by Russell Austin of Murphy Austin Adams Schoenfeld LLP (“Austin Memo”) discussing whether meetings by the EDFUND Board of Directors on the proposed Change in Control Severance Agreement (“severance agreement”) must be held in open session under state law. Mr. Austin concludes that state law permits the EDFUND Board of Directors to meet in closed session to discuss the severance agreement. I strongly disagree with this conclusion and I recommend that the Commission convey to the EDFUND Board of Directors its expectation that the Board of Directors will conduct its discussion of the severance agreement in an open session in conformity with state law.

**A. Concerns Relating to the Analysis of the “Proprietary” Exception Found in Education Code Section 69525(g)(2)**

The Austin Memo found that the EDFUND Board of Directors had authority under Education Code section 69525(g)(2), the “proprietary exception” to meet in closed session to discuss the severance agreement. The Austin Memo discussed the legislatively expressed need for EDFUND to be competitive in the loan marketplace and concluded:

Consequently, since the recruitment and retention of qualified management personnel is crucial to effective competition in the marketplace, it seems logical that the legislative intent behind 69525(g)(2) would include discussions of the [severance] Agreement. Requiring that such discussions be conducted in open meetings would result in the disclosure of proprietary information about EDFUND’s executive compensation that could result in significant economic harm to EDFUND and inhibit its ability to compete effectively by making it more difficult to hire and retain key management personnel.

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This conclusion ignores key facts regarding the public nature of the compensation paid to EDFUND executives, the context in which the proprietary exception was added to the Education Code, and the general framework in which state agencies are given the ability to meet in closed session on items necessary to protect the state agency's ability to operate in a competitive marketplace.

The Austin Memo asserts that the severance agreement is proprietary because the ability to recruit and retain "qualified management personnel is crucial to effective competition in the marketplace" and that "disclosure of proprietary information about EDFUND's executive compensation ... could result in significant harm to EDFUND." Information about the compensation paid to EDFUND executives is already available to the public through the Annual Report and, as such, there is nothing "proprietary" about this information. The Austin Memo also fails to explain the "significant harm" that EDFUND will experience, especially considering that EDFUND's executive compensation information is already available to the public.

Furthermore, there is no part of this severance package which is intended as a recruitment tool. This severance package is being offered to executives who are already employees of EDFUND and who already agreed to the terms and conditions of their employment. To indicate otherwise is misleading. Lastly, at the same time that the "proprietary" exception was added to Education Code section 69525, Senate Bill 1108 ("SB 1108") also amended Education Code section 69529.5. That amendment provided: "The commission shall report the following information to the Legislature on April 1 of each year ..., with respect to the operation of the auxiliary organization: ... (4) the level of compensation of managers and executives of the auxiliary organization."

The context in which the proprietary exception was added to the Education Code is also at odds with the "logical" inference reached by the Austin Memo that the legislative intent behind 69525(g)(2) would permit discussion of a severance agreement. SB 1108 was the legislation that authorized EDFUND to diversify its Federal Family Loan Program activities. SB 1108 provided the following:

This bill would authorize the auxiliary organization to participate in activities approved by the commission and determined by the commission to be related to student financial aid, consistent with the general mission of the commission, and consistent with the purposes of prescribed provisions of federal law that are related to student financial aid. The bill would authorize the board of directors of the auxiliary organization established by the commission to meet in closed session to consider matters of a proprietary nature under certain circumstances.

There is nothing in this language which indicates an intention to abrogate the general rule that public employee salary and benefits are of public interest and should be considered in open session by public bodies. Other state agencies doing business in competitive markets, such as the California Public Employees' Retirement System and the California State Teachers' Retirement System, have business related closed session exceptions for items related to the purchase, lease and sale of real property and other investment decisions. (See Govt. Code section 11126(c)(7)(A) and 11126(c)(16).) However, I am not aware of any state agency which has claimed that an exclusion of this type extends so far as to encompass the salary and benefits of its executives. Indeed, both CalPERS and CalSTRS have specific statutory authority to hold closed session meetings pertaining to "recruitment, appointment, employment or removal" of the chief executive officer or chief investment officer of these particular agencies but the discussion of salaries, bonuses and benefits is conducted in open session by both agencies. The clearest indicator by the Legislature of how it expected EDFUND to conduct its meetings is

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the fact that EDFUND was, from the outset, statutorily mandated to comply with the Bagley-Keene Open Meeting Act. As will be discussed below, the personnel exception of the Bagley-Keene Open Meeting Act similarly does not apply and, as a result, discussions relating to the severance agreement must be held in open session by the EDFUND Board of Directors.

**B. Concerns Relating to the Analysis of the "Personnel" Exception Found in Government Code Section 111266(a)(1)**

The Austin Memo also found that the EDFUND Board of Directors could meet in closed session to discuss the severance agreement under the Bagley-Keene Open Meeting Act. The Austin Memo specifically noted "while there is some uncertainty under case law as to whether discussions of salary and benefits fit within the 'personnel' exception to the Bagley-Keene Act (sic), we conclude it is more likely than not this exception extends to salary and benefits, which would in turn include consideration of the [severance] agreement."

I disagree that there is much uncertainty about whether discussion of salary and benefits is an appropriate use of the "personnel" exception. In *San Diego Union v. City Council of the City San Diego*, 146 Cal. App. 3d 947, the court discusses that, under the Brown Act, salaries for public officials must be discussed in open session. The pertinent language in the Brown Act which is discussed in this case mirrors the language found in the Bagley-Keene Open Meeting Act. The court found:

The people of this State do not yield their sovereignty to the agencies which serve them. The people, in delegating authority, do not give their public servants the right to decide what is good for the people to know and what is not good for them to know. The people insist on remaining informed so that they may retain control over the instruments they have created." The Brown Act provides for a "personnel exception" in allowing closed sessions when the governmental entity is "meeting to consider the appointment, employment, evaluation of performance or dismissal of a public employee or to hear complaints or charges brought against such employee by another person or employee unless such employee requests a public hearing." The parties agree the underlying purposes of the "personnel exception" are to protect the employee from public embarrassment and to permit free and candid discussions of personnel matters by a local governmental body.

Mindful we must construe the "personnel exception" narrowly and the "sunshine law" liberally in favor of openness, we reject the City Council's arguments the term "employment" be broadly interpreted so as to encompass the terms and conditions of continued employment of which salary level determination is an integral part or that the amendment providing for "evaluation of performance" be similarly interpreted. Our determination is consistent with the purpose and mandate of the Brown Act and the specific language of section 54957. Salaries and other terms of compensation constitute municipal budgetary matters of substantial public interest warranting open discussion and eventual electoral public ratification. Public visibility breeds public awareness which in turn fosters public activism politically and subtly encouraging the governmental entity to permit public participation in the discussion process. It is difficult to imagine a more critical time for public scrutiny of its governmental decision-making process than when the latter is determining how it shall spend public funds. With ever-increasing demands on public funds which have dwindled so drastically since the passage of Proposition 13, secrecy cannot be condoned in budgetary determinations, including the establishment of salaries. Granted, evaluating a

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specific employee's performance is a matter within the ambit of the "personnel exception" in light of the 1982 amendment to section 54957 however, upon the determination a particular public employee is deserving of a salary increase, various other factors must be considered such as available funds, other city funding priorities, relative compensation of similar positions within the city and in other jurisdictions, before determining the salary increase. Each of these considerations is of acute public interest.

Further, there is no basis for the apparent underlying assumption of the City Council's argument that it cannot evaluate the performance of the cited public employees without also establishing their salaries in executive session. Consistent with both the "personnel exception" as to the evaluation of performance of a particular employee and the general mandate of the Brown Act, we envision the two-step process of an executive session evaluating the performance of the public employee and a properly noticed, open session for setting that particular employee's salary as a facile matter, not negatively affecting the review process. Common sense compels the conclusion that oblique references to discussions of salaries for specific individuals within executive sessions evaluating the performance of that public employee would not violate the Brown Act so long as the specific discussions as to the amount of salary increase are reserved for a properly noticed, public meeting.

As noted by the court, the purpose behind the "personnel" exception is "to protect the employee from public embarrassment and to permit free and candid discussions of personnel matters by a local governmental body." This is not the situation here. If the Legislature has intended salary and benefits to fall within the personnel exception it would have so provided. Instead, it limited the exception to "appointment, employment, evaluation of performance, or dismissal of a public employee." Since none of these categories apply, the "personnel" exception does not apply and meetings on this severance agreement held in closed session violate state law.

**CONCLUSION**

By statute, the Commission is charged with the oversight of the activities of its auxiliary organization, EDFUND. This responsibility includes ensuring that EDFUND operates in conformity with state law. The Commission's own governance policy provides that the "Commission will understand, acknowledge, and hold the EDFUND Board accountable for its fiduciary responsibilities...". The governance policy also provides that:

EDFUND Board members are appointed by the Commission and are accountable to the Commission. ... As such, both the Board as a whole and individual Board members have certain fiduciary responsibilities and obligations with regard to the EDFUND organization. The Commission will hold the EDFUND Board, which it appoints, accountable to fulfill these fiduciary responsibilities and obligations. The Commission also has statutory responsibility to oversee its auxiliary, EDFUND. Thus, the Education Code establishes a two-tiered governance structure over EDFUND – the first tier being the EDFUND Board, the second being the Commission. To fulfill its governance role, the Commission will conduct oversight of EDFUND as required by law and deemed necessary and prudent by the Commission.

As the body ultimately responsible for the oversight of EDFUND, I urge the Commission to communicate to the EDFUND Board of Directors its expectation that the Board of

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Directors will follow state law and conduct its discussion of the severance agreement in an open session meeting in compliance with the Bagley-Keene Open Meeting Act.

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# CALIFORNIA STUDENT AID COMMISSION

OFFICE OF THE EXECUTIVE DIRECTOR



May 19, 2008

Sister Sally Furay, Chair  
EDFUND Board of Directors  
1653 Borana Street  
San Diego, CA 92111-6939

Dear Chair Furay:

It is my understanding that at the May 15, 2008 meeting of the EDFUND Board of Directors, the EDFUND Executive Committee was delegated the authority to "confer with the California Student Aid Commission and the Department of Finance regarding the Board's right to deliberate in closed session [on] matters relating to the sale of the corporation, including the retention of key employees." Prior to the Commission chair and staff participating in such a meeting, the Commission will need to be briefed and have the opportunity to discuss the events that have occurred with respect to this matter. The Commission has noticed its meeting on this issue for May 27, 2008. On the advice of legal counsel, the Commission will be hearing and deliberating on this item in open session pursuant to the Bagley-Keene Open Meeting Act.

In addition, I am requesting that any meeting between representatives from the Commission, EDFUND and Department of Finance include a representative from the Office of the Attorney General. Since this is an issue of the legal interpretation of a state statute, their opinion should be considered in reaching a resolution of whether this is an appropriate item for closed session under the Bagley-Keene Open Meeting Act.

Finally, I continue to strongly urge the Board of Directors to hold meetings on this topic in open session. Considering the fact that the proposed severance package for EDFUND executives has become an item of public discussion and interest, any claim that such an agreement is not subject to the open meeting requirements of the Bagley-Keene Open Meeting Act, or is "proprietary" within the meaning of the exception found in the Education Code, is largely unsupported.

If you have any questions, or would like to discuss this matter, please feel free to contact me.

Sincerely,

Dennis J. Galligani  
Chair

CC: Members of the California Student Aid Commission  
Members of the EDFUND Board of Directors  
Mr. Fred Klass, Chief Operating Officer  
Ms. Jeannie Oropeza, Program Budget Manager

# CALIFORNIA STUDENT AID COMMISSION

OFFICE OF THE EXECUTIVE DIRECTOR



May 30, 2008

Sister Sally Furay, Chair  
EDFUND Board of Directors  
1653 Borana Street  
San Diego, CA 92111-6939

Dear Chair Furay:

The California Student Aid Commission met on Tuesday, May 27, 2008 to discuss its concerns regarding the Board of Directors of EDFUND meeting in closed session on the Executive Change-In-Control Severance Agreements for senior management. As Chair of the Commission, I previously communicated my concerns that these closed session meetings violated the Bagley-Keene Open Meeting Act on May 2, 2008, May 9, 2008, and May 19, 2008.

At the May 27, 2008 meeting, the Commission took the following action, and offers the following direction, to the EDFUND Board of Directors. The Commission expects that no further meetings on the Executive Change-In-Control Severance Agreement will take place in closed session until after the Commission has the opportunity to have further discussion on the issue at its June 26-27, 2008 meeting.

In addition, it is requested that the EDFUND Board avoid any meeting, discussion, or action in closed session that directly or indirectly advances the issue of severance, retention, or existing compensation for EDFUND executive management until the matter is fully addressed following the Commission's June meeting.

Please let me know if you have any questions.

Sincerely,

Dennis J. Galligani  
Chair

CC: Members of the California Student Aid Commission  
Members of the EDFUND Board of Directors  
Mr. Fred Klass, Chief Operating Officer  
Ms. Jeannie Oropeza, Program Budget Manager

**DRAFT**  
**CALIFORNIA STUDENT AID COMMISSION**  
**POLICY ON**  
**EDFUND**  
**EXECUTIVE COMPENSATION**

**I. POLICY STATEMENT**

EDFUND is a loan services auxiliary operating as the non-profit auxiliary of the California Student Aid Commission (Commission), and provides operational and support services to the Commission, including the Commission's administration of the Federal Family Education Loan Program (FFELP). EDFUND shall provide to its executives direct compensation programs and potential earnings opportunities that reflect and perpetuate the mission of EDFUND in "*maximizing benefits to borrowers by being the premier service provider in the student loan industry*" and which consider the charitable purpose for which EDFUND was created, "*to promote and assist the programs of the California Student Aid Commission.*"

To encourage superior customer service, profitable growth and operating performance, as well as continued maximization of benefits to borrowers, EDFUND's pay and incentive programs will reward both individual and organization performance which emphasizes these goals and results. Programs are designed to:

- ❖ Attract, retain, and motivate highly qualified executives to achieve mission-critical outcomes;
- ❖ Provide overall compensation and benefit opportunities consistent with reasonable, blended market-based and State-based pay packages;
- ❖ Support the organization's mission, purpose and strategic objectives by aligning rewards with accomplishing those objectives; and
- ❖ Provide appropriate rewards for superior organization and individual performance and skills.

This policy shall apply to the review, establishment and administration of all cash and non-cash compensation policies and programs and major changes in EDFUND's benefit plans that are applicable to the President and members of the Executive Management Team as well as any other individual or groups the Board of Directors and the Commission deem appropriate, based upon an informed interpretation of the definition of "disqualified persons" in Section 4958 of the Internal Revenue Code of 1986. It shall be EDFUND's policy to perform its duties in a manner that will establish a presumption that the total remuneration packages offered to the President, the Executive Management team, and other "disqualified persons" are reasonable.

**II. EXECUTIVE COMPENSATION PROGRAMS**

***Base Salary Program***

**DRAFT**

The objective of the base salary program shall be to provide a blended market-based and State-based program, as approved by the Commission, for functionally comparable positions. EDFUND's positioning for base salary will consider:

- ❖ Organizational need and the identification of exceptional talent in cases warranting above-standard positions, as approved by the Commission;
- ❖ The individual's performance, skill set and experience, as well as the position's relationship to market and State-based data, as approved by the Commission;
- ❖ Possible adjustment annually and positioning with the reasonable market and State-based range, as approved by the Commission; and
- ❖ A range generally within ten percent of the median or 75<sup>th</sup> percentile ranges of comparable positions, adjusted to reflect scope, functionality and complexity, as approved by the Commission.

***Annual Incentive Plan (AIP)***

The objective of the AIP shall be to reward the successful achievement of the organization's purposes and annual strategic business goals and to provide competitive variable compensation opportunities. The AIP should balance both financial and individual goals and:

- ❖ Participants should have authority, influence and/or control over individual goal achievement;
- ❖ Plan payments should be reasonable and commensurate with individual performance and company affordability and be aligned with comparable market opportunities;
- ❖ Consistent with Commission Policy Statement and Guidelines on EDFUND Incentive Compensation Plans, a precondition for incentive compensation requires that the year-end Loan Program Revenues Net of Expenses will be a surplus and other preconditions approved by the Commission as part of the process for adopting the annual Loan Program Business Plan and Budget;
- ❖ The recommendation and payment of any annual incentive amount will consider both the organization's and the individual's performance and will be within a reasonable market range given the contribution of the individual and organizational results as well as the value of the total compensation package; and
- ❖ The benchmark and cap on executive annual incentive compensation is set at twenty percent of annual base salary of the participants and shall be approved by the Commission each year. In calculating the actual individual incentive compensation amounts:
  - (A) Seventy-five percent (fifteen percent of annual base salary) shall be based on the company's overall performance score consistent with the goals adopted in the annual business plan, and
  - (B) Twenty-five percent (five percent of annual base salary) shall be based on individual performance.

***Benefit Plans***

EDFUND's Executive Benefit Plans will reflect what is typical practice among similar organizations and be targeted to provide market median levels of compensation. The objective of benefit plans is to assist in the long-term well being and retention of employees and includes:

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- ❖ Health and Welfare plans which are provided to protect and care for employees and their families under certain circumstances;
- ❖ Executive Retirement plans (including qualified and supplemental plans) which provide a total retirement package to senior level executives that targets between the median and 75<sup>th</sup> percentile of typical market practice, with an emphasis on long-term employment;
- ❖ Supplemental Benefits which will not be emphasized and will be provided only if prevalent and significant in attracting and retaining executive talent;
- ❖ Perquisites, per se, which will not be provided. If an automobile allowance is provided to the President, it shall be consistent with typical market and State practice and be expressly approved by the Commission;
- ❖ Relocation policies will be designed to provide reasonable short-term assistance to new or transferring employees relocating from one area to another, as a recruiting tool, consistent with competitive practice; and
- ❖ EDFUND shall not provide loans to its executives.

***Employment Contracts, Severance Benefits and Retention Packages***

EDFUND does not utilize employment contracts, severance benefits or retention packages for its executives.

***Impact of Section 4958 of the Internal Revenue Code***

EDFUND, through its governing bodies (PEN Committee, Executive Committee and Board of Directors) shall make every effort to establish a presumption that the total remuneration packages provided to its President and Executive Management Team are reasonable, as such presumption is contemplated in Section 4958 of the Internal Revenue Code of 1986, as amended from time to time.

**III. RESPONSIBLE BODIES**

Three EDFUND bodies shall have responsibilities in carrying out EDFUND's Executive Compensation Policy. In addition, the President's incentive compensation amount and the total incentive compensation pool amount for the Executive Management Team are referred to the Executive Director and Chair of the Student Aid Commission.

The **EDFUND PEN Committee** is responsible for assessing the market for reasonable, comparable and appropriate data with which to compare each executive's total compensation package. The EDFUND PEN Committee *provides its assessment* to the EDFUND Executive Committee.

The **EDFUND Executive Committee** reviews and considers the market assessment, along with related information on organizational and individual performance, and *provides its recommendation* as to pay actions and awards for each executive to the EDFUND Board of Directors. The EDFUND Executive Committee recommends executive pay actions and policies/programs, or charges thereof, with respect to any payment or program that impacts the executive compensation package for disqualified persons.

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The **EDFUND Board of Directors** has the authority to *approve* the recommendations on any element, change or payment related to executive pay packages.

The Commission shall approve all executive compensation packages.

**IV. INDEPENDENCE**

All members of the EDFUND Board of Directors, as well as the Commission Executive Director shall be independent and have no conflicts of interest, as defined in Internal Revenue Code Section 4958. A member of the authorized body does not have a conflict of interest with respect to a compensation arrangement or property transfer only if the member:

- (A) Is not a disqualified person participating in or economically benefiting from the compensation arrangement or property transfer, and is not a member of the family of any such disqualified person, as described in section 4958(f)(4) or §53.4958-3(b)(1);
- (B) Is not in an employment relationship subject to the direction or control of any disqualified person participating in or economically benefiting from the compensation arrangement or property transfer;
- (C) Does not receive compensation or other payments subject to approval by any disqualified person participating in or economically benefiting from the compensation arrangement or property transfer;
- (D) Has no material financial interest affected by the compensation arrangement or property transfer; and
- (E) Does not approve a transaction providing economic benefits to any disqualified person participating in the compensation arrangement or property transfer, who in turn has approved or will approve a transaction providing economic benefits to the member.

All independent members will complete a statement of independence at least annually, which will be reviewed by EDFUND's Legal Counsel.

**V. ROLES AND RESPONSIBILITIES**

Each EDFUND entity will carry out this policy in the following manner:

**A. EDFUND PEN Committee**

To determine the relevant market data for each position within the Executive Management Team, the EDFUND PEN Committee obtains and reviews reliable and comparable data from a select peer group of not-for-profit student loan operations with an emphasis on revenue, budget, complexity and mission. EDFUND's revenue and budget will approximate the median for the select group. The peer group data will be supplemented by published survey data from a recognized, independent source representing similarly-sized, not-for-profit and for-profit financial services organizations. In light of its role as an auxiliary to a public entity, EDFUND will also consider the salary data for comparable Exempt, Career Executive Assignment and Civil Service classifications within the State of California for each position within the Executive Management Team. EDFUND will assign a weighting to the

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different sources to reflect the appropriate market for talent for functionally comparable positions within the loan servicing industry as follows:

Peer Group	50%
Not-for-Profit Financial Services Organizations (survey)	25%
For-Profit Financial Services Organizations (survey)	15%
Exempt, Career Executive Assignment, Civil Service	10%

This weighting may be revised from time to time based on the determination of the PEN Committee. The rationale for any such revisions will be documented in the minutes of the PEN Committee’s meetings.

To determine the appropriate market levels for comparison and to assess each incumbent executive accordingly, total compensation ranges will be created based on the appropriate market data sources for base salary, total cash compensation (base salary plus annual incentives), total retirement, supplemental benefits and perquisites and total compensation (combination of all elements). The incumbent’s current compensation package will be presented for comparison purposes against these comparable ranges for both the median and 75<sup>th</sup> percentiles of the comparable market data. A summary of the analysis will be provided to the EDFUND Executive Committee for each individual executive.

**B. EDFUND Executive Committee**

The EDFUND Executive Committee’s responsibility is to review the market assessments provided by the PEN Committee along with additional input to create its recommendations for pay actions and policy/program changes. The Executive Committee will seek input from the President and other members of the Executive Management Team as appropriate when assessing pay data. In reviewing the comparable data, organizational performance against budgets and expectations, individual performance objectives or indicators, the financial position of EDFUND and any pertinent facts and circumstances will be considered. In making its recommendations, the Executive Committee will seek proposed changes, as well as performance criteria, from EDFUND’s President for each member of the Executive Management Team. The Executive Committee will refer to all applicable Policy statement for elements of total compensation, and will consider the value of the compensation package in its entirety against the comparable data. The Executive Committee will present its recommendation to the Board of Directors for each individual, with related rationale and supporting information.

When establishing annual incentives, the Executive Committee will work with the President and Executive Management Team as needed to incorporate into the annual incentive program design the objectives and milestones associated with key strategic initiatives. Annually, the Executive Committee will review with the Board of Directors the goals and objectives proposed by the President for EDFUND and the individual objectives for each Executive Management Team member.

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The Executive Committee will evaluate the President's performance and the performance of the Executive Management Team in light of the goal established before recommending to the Board of Directors the annual incentive award amount and/or other incentives or benefit. The Executive Committee's evaluation will consider the President's input and the performance of each executive against established quantitative metrics and qualitative assessments.

The Executive Committee is also responsible for developing this policy and reviewing it at least every three years, deciding upon any modification it deems, reasonable, competitive, and equitable, to ensure that the Policy supports the long-term interests of EDFUND and provides a competitive and performance-oriented compensation opportunity for executives managing the organization. The Executive Committee will propose to the Board of Directors any modification to the philosophy or to the individual plans, programs or policies. The Executive Committee will fully, consistently and faithfully apply the policy in a manner that will establish the presumption that total compensation decisions are reasonable under the provisions of Internal Revenue Code Section 4958 or Intermediate Sanctions.

**C. EDFUND Board of Directors**

The Board of Directors will review the evaluation, appropriate comparable data and recommendations of the Executive Committee before finalizing any salary, annual incentive award and/or other incentives or benefits decisions for the members of the Executive Management Team. The EDFUND Board of Directors is responsible for approving any cash or non-cash form of executive compensation and benefits as well as each payment accrued or paid. The Board of Directors will fully, consistently and faithfully apply the policy in a manner that will establish the presumption that total compensation decisions are reasonable under the provisions of Internal Revenue Code Section 4958 or Intermediate Sanctions.

All information relating to the consideration and approval by the EDFUND PEN Committee, Executive Committee, and Board of Directors, shall be provided to the Commission, and the Commission must approve any and all actions relating to executive compensation and benefits before they become effective.

**VI. RECORDS AND SUPPORT**

Each Committee and the Board of Directors will review, discuss and deliberate the matters under their purview and prepare minutes of each meeting in which executive compensation is discussed. The minutes will reflect the decisions made, members present, nature and source of data or information considered, any explanation or rationale for each decision for each executive, the identity of each person voting on the matter, and the voting results. Preparation of the minutes should be completed prior to the next Board or Committee meeting, but in no event later than sixty (60) days after such Board or Committee meeting.

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The EDFUND PEN Committee, EDFUND Executive Committee and the EDFUND Board of Directors shall retain the right to consult and may engage the professional services of independent legal counsel, compensation experts, accountants and other experts and external advisors on matters related to executive compensation policies, practices and market data. All professional services must be approved by the Commission before any service is provided. All advice and information from a professional service provider shall be provided contemporaneously to the Commission.