

**CORPORATE GOVERNANCE**

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**PROXY VOTING  
GUIDELINES**

September 2003

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# I. BOARD INDEPENDENCE & LEADERSHIP

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## A. Board Shareowner Accountability

### i. Majority of Independent Directors

**Issue:** Independence is an essential characteristic for a board of directors, who is charged with selecting and monitoring a corporation's management team, instilling accountability, and representing the long-term interests of shareowners. Individuals with financial or other ties to the corporation may not be able to exercise independent judgment on behalf of the shareowners in monitoring management.

**Guideline:** a) We support boards where at least two-thirds of the director nominees can be identified as completely independent; if this threshold does not exist, we oppose individual non-independent directors. b) We support proposals seeking to increase the independence of the board.

### ii. Board Nominees Qualifications

**Issue:** The primary goal of director selection is to nominate individuals who, as a group, offer a range of specialized knowledge, skills, and perspective that can contribute to the successful operation of the corporation<sup>1</sup>. A board of directors, and subsequently the corporation, may benefit from the different perspectives that a diverse slate brings.

**Guideline:** a) We support boards that are composed of qualified individuals who reflect a diversity of experience, gender, race, and age. b) We support proposals seeking to report on a corporation's efforts to increase board inclusiveness.

### iii. Separate Chair and CEO Positions

**Issue:** The Chairperson of a corporation is the leader of the board, which is responsible for selecting and replacing the CEO, setting executive pay, monitoring and evaluating management's performance, and representing the long-term interests of shareowners. The CEO is responsible for managing the day-to-day operations of the corporation, acting as its spokesperson, and formulating strategy for board approval. The separation of these positions may be required to foster a clear division of responsibility and accountability.

**Guideline:** a) We support proposals seeking to separate the positions of chairperson and CEO. b) We support proposals that call for an independent director to function as board chairperson.

### iv. Lead Director

**Issue:** In the case where the chairman of the Board and the CEO are same position, a lead director may be appointed. This would create a formal leader for the outside directors, but would not usurp the chairman/CEO's role as board leader. This measure may be necessary for the principles of independence and accountability to be preserved.

**Guideline:** In the case where the chairperson of the corporation is also the CEO, we support proposals that seek to install a totally independent lead director of the board.

### v. Classified boards

**Issue:** A common anti-takeover measure, classified boards are those with staggered terms. Typically, a classified board structure means that one-third of the board is elected in any given year. Staggering directors' terms makes it more difficult for dissidents to seize control of a target company, since only one-third of the directors stand for election in any one year. A declassified board is a necessary component for maintaining shareowner accountability.

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<sup>1</sup> Definition from the National Association of Corporate Directors.

**Guideline:** a) We oppose the establishment of classified boards and support annual elections of all directors. b) We support proposals seeking the declassification of the board.

#### **vi. Complete Independence of Key Committees**

**Issue:** Key committees of the board of directors – audit, nominating, and compensation – should be composed entirely of independent directors. The nature of responsibility of those committees requires objectivity that only independent directors can provide. (a) **Audit Committee:** A subset of the board of directors with a responsibility to oversee the organization’s financial reporting, risk management and audit processes. (b) **Nominating committee:** A subset of the board of directors that has a responsibility to nominate candidates for board seats. (c) **Compensation committee:** A subset of the board of directors with a responsibility to determine the compensation strategies for the company’s top executive officers, including salary, bonus, stock and performance- based remuneration.

**Guideline:** a) We oppose individual non-independent directors nominated to these three key committees. b) We support proposals seeking to increase the independence of these key committees.

#### **vii. Director and Officer Indemnification and Liability Protection**

**Issue:** Directors and officers may become subject to legal exposure arising from a breach of, or failure to perform, any duty resulting solely from their status as a director. When a corporation indemnifies its directors and officers it means the corporation promises to reimburse them for certain legal expenses, damages and judgments incurred as a result of lawsuits relating to their corporate actions. Individuals may also be subject to personal liability as a result of their status as a director, and be responsible for certain legal expenses, damages, settlements or fines. Management proposals have been introduced that seek to limit a director’s liability for (i) a breach of the duty of loyalty, (ii) acts or omissions not in good faith or involving intentional misconduct or knowing violations of the law, (iii) acts involving the unlawful purchase or redemption of stock, (iv) the payment of unlawful dividends or (v) the receipt of improper personal benefits. Limitations on directors’ liability can benefit the corporation and its shareholders by facilitating the attraction and retention of qualified directors and officers.

**Guideline:** a) We oppose proposals that seek to limit or eliminate directors’ and officers’ liability for monetary damages for violating the duty of care. b) We oppose proposals that seek to expand indemnification coverage for intentional acts or criminal acts that are more violations of fiduciary obligation than mere negligence.

#### **viii. Size of Board of Directors**

**Issue:** A corporation’s articles of incorporation or by-laws typically establish the size of the board. The Council on Institutional Investors states that a board should be neither too small to maintain the needed expertise and independence, nor too large to be efficiently functional, and recommends that a board be comprised of five to fifteen members.

**Guideline:** a) We will support proposals to fix the size of the board at a specific, reasonably determined number of directors. b) We oppose proposals that seek to increase or decrease the size of the board without shareholder approval. We oppose proposals that seek to reduce the size of the board as a cost-cutting measure.

#### **ix. Mandatory Attendance of Directors**

**Issue:** In order to effectively perform their duties, directors are expected to attend a majority of meetings each year. The threshold for “acceptable” attendance is considered to be 75%, because this allows for unanticipated emergencies and occasional conflicts. There is a concern that “absentee” directors are not fulfilling their fiduciary duties to shareowners.

**Guideline:** Absent compelling and stated reasons, we oppose individual director nominees who attended less than 75% of the board and committee meetings that they were scheduled to attend during the previous year.

## **x. Tenure and Retirement Policies**

**Issue:** In order to avoid entrenchment and foster the recruitment of board nominees with new viewpoints and approaches, certain mechanisms like term limits and mandatory retirement provide a means to impose director turnover. Furthermore, boards are often reluctant to undertake rigorous director evaluation processes. However, arbitrarily limiting the period of time a director can serve on the board may force qualified, experienced, and knowledgeable directors off the board and could conceivably harm shareowners' interests.

**Guideline:** a) We will consider proposals seeking to adopt director tenure policies on a case-by-case basis. b) We will consider proposals seeking to adopt director retirement policies on a case-by-case basis.

## **xi. Limitations on Multiple Directorships**

**Issue:** It is widely held that service on too many boards can interfere with the performance of board members. Sufficient time, preparedness, and attention are required for directors to satisfy their commitments as a member of the board. The National Association of Corporate Directors recommends that director candidates who are CEOs or senior executives of public corporations be preferred if they hold no more than 1-2 public company directorships; other candidates who hold full-time positions be preferred if they hold not more than 3-4 public company directorships; and all other candidates be preferred if they hold no more than 5-6 other public company directorships.

**Guideline:** We oppose individual director nominees who face competing time commitments by serving on too many boards. This includes individuals with full-time jobs serving on more than 2 other boards, or other individuals serving on more than 4 boards.

## **B. Policies for Auditing Firms**

### **i. Ratification of Auditing Firm**

**Issue:** Each year shareholders have the opportunity to ratify the company's selection of an auditing firm.

**Guideline:** In most cases, we support proposals to ratify auditors. However, we oppose ratification if there is reason to believe that the independent auditor has rendered an opinion that is neither accurate nor indicative of the company's financial position.

### **ii. No Consulting by Auditors**

**Issue:** Many audit firms provide other business services, such as consulting, to the corporations on which they perform audits. In recent years, the non-audit fees often surpass those paid for auditing services. Increasingly, shareholders are requesting board of directors to adopt a policy that the company's independent auditors will provide only audit services to the company and will not provide any other services. Concern over audit quality have stemmed largely from fear that the non-audit relationships may impair independence, especially when non-audit fees significantly exceed the amount paid for auditing services.

**Guideline:** a) We support proposals seeking the adoption of a policy that the corporation's independent auditors only provide audit-related services and not provide any other services. b) We support ratification of a corporation's selection of an auditing firm if that firm does not perform significant (50% of the auditing firm's annual fees) consulting services to the corporation.

## **C. Board Compensation**

### **i. Cash & Stock**

**Issue:** Members of the board of directors of publicly owned companies receive compensation for their services. Compensation typically includes base pay and supplemental equity-based pay. It is generally accepted that Directors' interests must reflect those of the shareowners.

**Guideline:** We support reasonable director compensation packages that are a combination of cash and stock.

## ii. **Mandatory stock ownership**

**Issue:** One of the best ways for directors to align their interests with those of the shareowners is to own stock in a corporation. However, requiring directors to purchase stock in the corporation may impose an unnecessary financial restriction on the qualifications for independent directors. Share ownership by directors better aligns their interests with those of other shareholders, and meaningful share ownership by directors is in the best interest of the company. What constitutes a “material” amount will necessarily vary widely from one director to another; however, a reasonable minimum ownership interest could be defined as stock holdings equal to approximately one year’s compensation as a board member.

**Guideline:** a) We support proposals that seek to require that board members own a meaningful position in company common stock, appropriate to their personal circumstances. b) We oppose proposals to establish minimum stock ownership requirements for directors.

## iii. **Conflicts of Interest**

**Issue:** A “conflict of interest” may occur when a board member’s private interest interferes in any way - or even appears to interfere - with the interests of the corporation as a whole. A conflict situation can arise when a director takes actions or has interests that may make it difficult to perform his or her company work objectively and effectively. Conflicts of interest also arise when a director receives improper personal benefits as a result of his or her position in the company. Loans to, or guarantees of obligations of, such persons are of special concern.

**Guideline:** We support proposals that seek to ensure that conflicts of interest do not occur with respect to a board member’s personal, financial or professional interests, and that board members not serve as a consultant or paid advisor to the corporation. We support proposals seeking disclosure of directors’ conflicts of interests.

## iv. **Pension for Directors**

**Issue:** Some companies offer retirement benefits for non-employee directors. Directors are adequately compensated through cash retainers and stock option grants, and most non-employee directors serving on a corporations’ board receive retirement benefits from their own employer.

**Guideline:** We support proposals that seek to eliminate retirement benefits for non-employee directors.

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# II. SHAREOWNER RIGHTS

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## A. **Voting Rights**

### i. **Confidential Voting**

**Issue:** Also known as closed voting or voting by secret ballot, under confidential voting procedures, all proxies, ballots, and voting tabulations that identify shareholders are kept confidential. Independent vote tabulators and inspectors of election are responsible for examining individual ballots, while management and shareholders are only told vote totals. Under a confidential voting policy, management does not know how shareholders vote on their proxy cards, or view ballots or voting tabulations that identify shareholders’ votes. This process is necessary to maintain a system free of pressure and coercion.

**Guideline:** We support proposals that seek to institute confidential shareholder voting procedures.

### ii. **Independent Tabulation**

**Issue:** Independent tabulators and inspectors of elections are responsible for examining individual ballots, while management and shareholders are simply given vote totals. Proxy voting should be conducted under the same rules of confidentiality that apply to voting in political elections.

**Guideline:** We support proposals that seek to institute independent tabulation shareholder voting procedures.

## **ii. Cumulative Voting**

**Issue:** A provision that permits shareholders to apportion the total number of votes they are entitled to cast in the election of directors in any fashion they desire. The total number is equal to the number of directors to be elected at the meeting multiplied by the number of shares eligible to be voted. With cumulative voting, each shareholder may cast the total number of votes that he or she is entitled to cast for one director, or apportion them among the candidates as desired. This practice provides minority shareholders a greater voice in the election of directors and increases the likelihood of minority shareholders on the board.

**Guideline:** We support proposals seeking to institute cumulative voting procedures at a corporation.

## **iii. Supermajority Voting Provisions**

**Issue:** A vote that requires support from more than a majority of the shares entitled to vote. Supermajority provisions establish shareholder vote requirements that are higher than the minimum levels set by state law to approve a merger or other business combination. These provisions are contrary to the principle of (simple) majority rule.

**Guideline:** We oppose proposals that require a supermajority shareholder vote to approve mergers and other significant business combinations and support proposals that seek to lower or eliminate these provisions.

## **iv. Supermajority Lock-in Provisions**

**Issue:** Provisions found in a corporation's charter or bylaws that require supermajority approval by shareholders to amend or repeal its existing provisions which make it more difficult to remove or alter takeover defense mechanisms. There is a concern that these provisions can be used as a management entrenchment device because higher votes are needed to amend or repeal a provision than it took to adopt the provision in the first place.

**Guideline:** We oppose proposals seeking to adopt supermajority lock-in provision to change certain bylaw or charter provisions.

# **B. Stock Related Proposals**

## **i. Common Stock Issuance**

**Issue:** Securities representing equity ownership in a corporation, providing voting rights, and entitling the holder to a share of the company's success through dividends and/or capital appreciation. Common stock increases are necessary for ordinary business purposes; however, an excessive amount of common shares authorized could cause unnecessary dilution in the voting power and market value of existing shareholders' holdings.

**Guideline:** We will consider proposals seeking to increase the number of authorized shares of common stock on a case-by-case basis.

## **ii. Dual Class Capitalization**

**Issue:** Some companies have two or more classes of common stock. The voting rights attached to each class of stock may (but do not always) vary from the one share per vote standard. Under some voting schemes, one class of stock will be granted super voting rights—typically five or 10 votes per share. In other instances, a class of shares may carry a fraction of a vote per share or none at all. Some companies also provide one or more classes of stock with special rights, such as the ability to elect a certain percentage of the directors. This practice digresses from the principle of one vote per share and multiple classes of stock can be used to entrench the board of directors and management of a corporation.

**Guideline:** We oppose the issuance of multiple classes of stock with unequal voting rights.

### iii. **Blank check preferred stock**

**Issue:** Preferred stock in which the board is given broad discretion to establish voting, conversion, dividend, and other rights of preferred stock at the time the board issues the stock. Some boards that have authority to issue blank check preferred stock have used it to create takeover defenses. Blank check preferred stock allows the board of directors the power – without shareholder approval – to establish voting, distribution, conversion and other rights for the stock, which may be used to implement certain takeover defenses that may not be in the shareowners’ best interest.

**Guideline:** We oppose the authorization or increase of blank check preferred stock.

### iv. **Share Repurchase Plan**

**Issue:** A program through which a corporation buys back its own shares in the open market, typically an indication that the corporation's management believes the stock price is undervalued.

**Guideline:** a) We support proposals seeking the approval of a share repurchase plan in which all shareowners participate on equal terms. b) We oppose proposals seeking the approval of a share repurchase plan if the repurchase program is initiated as a takeover defense measure.

### v. **Preemptive Rights**

**Issue:** The right of current shareholders to maintain their fractional ownership of a company by buying a proportional number of shares of any future issue of common stock. Most states consider preemptive rights valid only if made explicit in a corporation's charter. Preemptive rights allow existing shareowners the opportunity – should they chose to exercise their right – to prevent dilution in their relative ownership position when a company issues more stock.

**Guideline:** We support the creation or restoration of preemptive rights and oppose proposals seeking their elimination.

## C. **Other Shareowner Rights**

### i. **In-Person Annual Meetings**

**Issue:** Some corporations have lobbied to replace “face-to-face” annual meetings with “virtual meetings” broadcast over the Internet. Shareholders have argued that Internet access to annual meetings should only supplement and not replace in-person annual meetings. Annual in-person meetings guarantee that shareowners have the opportunity to speak directly to the corporation’s board of directors and management, and ask questions face-to-face.

**Guideline:** We support proposals seeking to affirm the continuation of in-person annual meetings.

### ii. **Right to Call a Special Meeting**

**Issue:** Most state laws authorize shareholders to call special meetings. Typically, shareholders holding from ten percent to one third of the shares may demand a meeting. Shareowners should have access to procedures that permit them to bring special circumstances to the attention of other owners, and without the right to call a special meeting may have to wait until the annual meeting to take action.

**Guideline:** We support shareowners’ rights to call a special meeting and oppose proposals seeking the elimination of this right.

### iii. **Right to Act by Written Consent**

**Issue:** The ability to act by written consent allows shareholders to take action collectively without a shareholders' meeting. The written consent procedure was developed originally to permit closely held companies to act quickly by obtaining consents from their shareholders. The procedure however is, available in many states to publicly traded companies as well, unless prohibited or restricted in a company's charter. Many companies have sought shareholder approval to restrict or abolish the written consent procedure; their

principal reason for doing so is to prevent takeovers opposed by the incumbent board and management. This right allows shareowners the ability to take action collectively without a shareowners' meeting. Corporations have sought shareowner approval to restrict or abolish the written consent procedure as a takeover defense measure.

**Guideline:** We support shareowners' right to act by written consent and oppose proposals seeking the elimination of this right.

#### **iv. Rotating Sites**

**Issue:** Some corporations conduct their annual meetings each year at their headquarter locations, while other companies rotate the site of the annual meeting around the country. Shareowners around the country should have an opportunity to participate in person, and the practice of rotating sites facilitates the ability to attend.

**Guideline:** We support proposals seeking to alternate the location of a corporation's annual meeting.

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### III. EXECUTIVE COMPENSATION & STOCK OPTION PLANS

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#### A. Executive Compensation

##### **i. Disclosure of Director and Executive Officer compensation levels**

**Issue:** Shareholders have asked companies to disclose the compensation it pays officers and executives who make more than a specified amount, usually those who are entitled to receive base salaries of more than \$250,000 annually.

**Guideline:** We support proposals requesting additional disclosure of the company's compensation philosophy, and executive officer and director pay information.

##### **ii. Shareholder Approval of Director/Executive Compensation**

**Issue:** This proposal asks the company to allow shareholders to vote on specific pay packages for company executives. Pay packages often include supplemental retirement benefit plans (SERPS), nonqualified pension benefits for executives that exceed IRS deductibility and are exempt from provisions within the Employee Retirement and Income Security (ERISA).

**Guideline:** a) We support proposals seeking to bring executive compensation packages to shareholders for ratification. b) We support proposals seeking shareholder approval of supplemental executive retirement plans. c) We support proposals seeking shareholder approval of any extraordinary pension benefits for senior executives under the company's supplemental executive retirement plans.

##### **iii. Performance-based incentive plans**

**Issue:** Shareholders have asked companies to link the pay packages of its executives to some measurement of corporate performance.

Some shareholders believe that only true operating income should be considered in determining executive compensation, and are advocating that pension fund surplus not be counted toward earnings when calculating performance-based compensation payouts or awards.

**Guideline:** a) We support proposals seeking to link executive pay with corporate performance, when performance is measured against indicators such as comparable peer groups and objective industry benchmarks. b) We support proposals that request the board to adopt a policy that executive compensation be determined in the future without regard to any amount of "periodic pension income" from a defined-benefit plan that accounting rules may require the company to treat as an addition to its income.

#### **iv. Link executive pay to social performance**

**Issue:** Shareholders have asked companies to report on any links it has between executive pay and social performance.

**Guideline:** We support proposals seeking to review, report on, or link executive compensation to non-financial criteria, including social and environmental goals.

#### **v. Golden Parachutes: Limitations & Shareholder Approval**

**Issue:** A clause in an executive employment contract that provides the executive with a lucrative severance package in the event of their termination. May include a continuation of salary, bonus and/or certain benefits and perquisites, as well as accelerated vesting of stock options.

**Guideline:** a) We support golden parachute severance agreements that are not in excess of one year's cash base salary. b) We support proposals in which golden parachutes are submitted for shareholder ratification.

#### **vi. Limit Director/Executive pay**

**Issue:** Shareholders have sought to influence executive compensation policy by bringing proposals to the Board of Directors that concern limiting, restricting or capping executive pay. Factors taken into consideration include the company's stock price, past compensation practices, peer group practices, and work-force reductions.

**Guideline:** We will consider proposals of this nature on a case-by-case basis.

#### **vii. Executive Bonus Plans**

**Issue:** Under Section 162(m) of the Internal Revenue Service Code, any compensation that qualifies as performance-based pay is tax deductible, and certain nonperformance-based pay in excess of \$1 million paid to certain top executives may not be deductible as a compensation expense. In order for cash bonuses to qualify as performance-based, a company must obtain shareholder approval of its plan's performance criteria and either the specific formula for bonus awards or the maximum award allowed under the plan.

**Guideline:** We will consider proposals and amendments to cash bonus plans on a case-by-case basis. We will generally vote against proposals to approve or amend cash bonus plans if the size of the bonus pool is not disclosed.

## **B. Stock Option Plans**

### **i. Shareholder Approval of Stock Option Plans**

**Issue:** Stock option plans are programs within a company whereby employees are allowed to buy a specific number of stock options in the company for a specified amount of time. Stock options give holders the right to purchase stock at a fixed price for a specified period of time. The options usually have an exercise price equal to the market price at the time the options were given. The difference between the exercise price and the market price is called the "spread" and constitutes the reward to the option holder. Using stock options to help more closely align the interests of executives and shareowners is a principle many investors support. However, concerns exist that current practices in executive compensation, particularly through the use of stock option plans, have contributed to an investing environment too focused on short-term earnings and stock prices.

**Guideline:** a) We support proposals seeking greater disclosure of stock option plans. b) We support proposals seeking the ratification of stock option plans by shareholders.

### **ii. Plans that exceed a dilution level threshold**

**Issue:** Dilution refers to the potential reduction in earnings per share resulting from the exercise of stock options. Dilution can affect voting power as well as earnings per share and dividends. Certain investors prefer to consider the dilutive impact of stock incentive in relation to the company's competitors. A company's peer

group is based on its market cap and economic sector (using the Standard & Poor's 11 economic sector categories and the market cap parameters in the S&P 500, S&P MidCap, and S&P SmallCap indices.)

**Guideline:** We oppose proposals seeking to adopt or amend stock option plans if the company's equity overhang, including from this proposal, exceeds the 75<sup>th</sup> percentile of its peer group.

### **iii. Plans that allow Discount Exercise Pricing**

**Issue:** This plan feature means that options have an exercise price less than fair market value on the grant date, – and is also called an “in-the-money” option. Concerns about discount exercise-pricing stems from the fact that this provision means that options can be immediately exercised for a profit.

**Guideline:** We oppose proposals seeking to adopt or amend stock option plans that provide for the practice of discounting exercise pricing.

### **iv. Plans that allow Replacing or Re-pricing Underwater Options**

**Issue:** This stock option plan feature provides the company the ability to lower the exercise price of options already awarded where the market price of the stock has declined below the original exercise price – i.e. the options are “underwater.” Concerns about this plan provision relates to the fact that it protects company executive, and not shareholders, from falling stock prices.

**Guideline:** a) We oppose proposals seeking to adopt or amend stock option plans that provide for replacing or re-pricing of underwater options. b) We will support proposals that require shareholder ratification in order to replace or re-price underwater stock options.

### **v. Plans that allow Pyramiding**

**Issue:** The practice of using shares obtained from the exercise of a few option shares to purchase additional shares covered under the option – in this situation, executives can exercise their options without any cash outlays.

**Guideline:** We oppose proposals seeking to adopt or amend stock option plans that provide for the practice of pyramiding.

### **vi. Plans that allow Reload Options**

**Issue:** A stock option plan feature in which a new option is granted for each exercise of a plan participant's stock options. These types of awards assure that early exercise of options does not result in the termination of the total amount of options granted, since each exercised option is replaced with a new option. Under this form of compensation, the risk that a plan participant will not have captured the highest stock price is eliminated because every time an option is exercised, another option replaces the exercised option, thus enabling the plan participant to continue to realize all the upside potential inherent in the original option grant.

**Guideline:** We oppose proposals seeking to adopt or amend stock option plans that provide for the practice of reloading.

### **vii. Plans that allow Accelerated Vesting**

**Issue:** A provision calling for all outstanding stock-based awards – whether or not vesting requirements have been met – to become fully exercisable. This may be triggered by a change-in-control event.

**Guideline:** We oppose proposals seeking to adopt or amend stock option plans that allow the practice of accelerated vesting.

### **viii. Stock option holding periods**

It is generally accepted that executives should acquire and hold a meaningful equity position in the company, which would encourage a long-term focus. Certain shareholders are concerned that an absence of stock option holding periods weakens the alignment of interests between management and shareholders.

**Guideline:** We support proposals that request the Compensation Committee of the Board of Directors adopt a policy that requires senior executives to retain a significant percentage (at least 75%) of shares acquired through equity compensation programs during their employment. b) We support proposals seeking a report to shareholders regarding the policy.

**ix. Plans that include an Evergreen feature**

**Issue:** A provision of a stock option plan that reserves a specified percentage of the outstanding shares (or an exact number of shares) for award each year – a “replenishment” feature.

**Guideline:** We oppose proposals seeking to adopt or amend stock option plans that include an evergreen provision.

**x. Company provides loans to allow exercise of options**

**Issue:** Certain companies have extended loans to employees to exercise their stock options. Critics of this practice claim it is not in the shareholders’ interest and that it is more appropriate for employees to obtain credit from more conventional, market-rate sources, such as banks or company credit unions.

**Guideline:** We oppose proposals seeking to adopt or amend stock option plans if a corporation provides loans to employees or directors to enable the exercise of options.

**x. Stock option Plans Developed/ Administered by a Compensation Committee that Includes Non-Independent Directors**

**Issue:** A company’s Compensation Committee of the Board of Directors is responsible for providing direction and oversight of the company’s executive compensation program. Through this committee the board of directors should ensure that the program complies with all ethical, regulatory and legal imperatives, and is reasonable relative to the shareholder value created. When the composition of this committee includes non-independent directors, there is a concern that objectivity with respect to the creation of stock option plans can become compromised.

**Guideline:** We will oppose stock option plans if non-independent directors serve on the Compensation Committee of the Board of Directors.

**xi. Expense Future Stock Options**

**Issue:** Current accounting rules - as determined by the Financial Standards Accounting Board - do not require companies to treat the value of stock options (a form of compensation) as an expense (although companies can treat them as an expense for tax purposes). The result is that the true cost of stock options is obscured, and included only as footnotes in a company’s financial statements. This practice has led to inflated earnings by companies, and many would assert that it has contributed to the wave of corporate accounting scandals.

**Guideline:** a) We oppose proposals seeking to adopt or amend stock option plans at companies that do not report options as a compensation expense. b) We support proposals that seek to require the company to report stock options as a compensation expense.

**xii. Plan is limited to a small number of senior employees**

**Issue:** Certain investors state that it is in the best interests of shareholders to favor stock option plans designed to promote more broad-based employee ownership over those plans that offer huge awards to a small subset of executives.

**Guideline:** We support resolutions that seek to limit stock options granted to a single individual to no more than 5% of the total options granted in a single year, and the group of senior executive officers to no more than 10% of the total options granted in a single year.

**xiii. Employee Stock Ownership Plans (ESOPs)**

**Issue:** An employee benefit program under which the company contributes a portion of its stock to an employee trust, usually as a form of profit sharing. Variants of these sorts of plans are the stock bonus plan,

the leveraged stock bonus plan (where the trust can borrow money from lending sources to buy more stock), and matching ESOPs (in which employees match the contribution that the company makes). ESOPs and their variants have value as tax-deferral devices for employees and as tax deduction vehicles for employers.

**Guideline:** We support proposals seeking to create an Employee Stock Ownership Plan, except in cases where they are being used as anti-takeover mechanisms.

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## IV. CORPORATE ACTIONS

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### A. Restructuring

#### i. Mergers, acquisitions, restructuring, recapitalization, spin-offs, sales of assets

**Issue:** Mergers, acquisitions, spin-offs and other forms of restructuring involve a change in control of the company's assets. Decision-making factors will include the effect on long-term performance, fairness to existing shareowners, and changes in corporate governance that may arise as a result of the deal. The decision may also involve appropriate investment staff or managers and proxy voting consultants.

**Guideline:** We will consider proposals of this nature on a case-by-case basis.

### B. Reincorporation and the Delaware Option

#### i. Reincorporation

**Issue:** Reincorporation refers to changing the state of incorporation. A company that reincorporates must obtain shareholder approval for the move and for the new charter it adopts when it shifts its state of incorporation. Many reincorporations involve moves to Delaware to take advantage of Delaware's flexible corporate laws.

Companies headquartered in the United States but incorporated in offshore tax havens such as Bermuda have raised concerns about reduced shareholder rights, and management accountability. Moreover, the perception that the offshore company is avoiding its tax obligations can have a negative impact on corporate image and brand name.

**Guideline:** a) We generally support proposals seeking the ratification of reincorporation for valid business reasons and if the reincorporation is in a state considered more "shareowner friendly." b) We oppose proposals seeking the ratification of reincorporation if they are to a state that provides for more takeover defense measures. c) We oppose proposals seeking reincorporation to an offshore location from the United States d) We support proposals to change the company's jurisdiction of incorporation from an offshore location to a state in the United States.

#### ii. Opt-out proposals

**Issue:** Proposals that give the shareholders the opportunity to choose whether or not to participate in state takeover laws. Most states allow corporations to opt out of state takeover laws if shareholders approve such an action. State takeover law confers a corporation's board of directors with too much power to decide on a sale of the company, a decision which should be made by the shareowners. Furthermore, state takeover law essentially requires a supermajority vote on a takeover decision.

**Guideline:** We support proposals seeking to opt out of a state anti-takeover statutory provision (including the Delaware takeover law) for valid business reasons.

## C. Takeover Defenses

### i. Payment of Greenmail

**Issue:** Greenmail refers to the practice of management repurchasing shares from a bidder at an above market price in exchange for the bidder's agreement not to acquire the target company. Greenmail is widely considered to be a form of blackmail. Some companies have attempted to deter greenmail by adding anti-greenmail provisions to their charters. A premium paid to a raider to get him/her to terminate a takeover attempt. There is a concern that this practice can be used as an entrenchment device for management and a way to prevent a merger or takeover from happening.

**Guideline:** We oppose the payment of greenmail and support proposals seeking to institute anti-greenmail provisions.

### ii. Poison Pills Shareholder Rights Plans

**Issue:** The popular term for a takeover defense that permits all shareholders other than an acquirer to purchase shares in a company at a discount if the company becomes a takeover target. A company with a pill (also known as a shareholder rights plan) usually distributes warrants or purchase rights that become exercisable when a triggering event occurs. The triggering event occurs when an acquirer buys more than a specified amount of a target company's stock without permission of the target company's board. Once the pill is triggered, shareholders (except for the acquirer) usually have the right to purchase shares directly from the target company at a 50-percent discount, diluting both ownership interest and voting rights. Most pills have provisions that permit the board to cancel the pill by redeeming the outstanding warrants or rights at nominal cost. Pills can force acquirers to bargain directly with a target company's board, but they can also be used to deter or to block acquisition bids altogether. Companies are not required by law to submit their poison pills for shareholder approval, and very few companies have chosen to seek shareholder approval. Poison pills can be considered aggressive takeover defense mechanisms which discourage takeover offers from ever being initiated, as well as deny shareholders the right to consider offers themselves.

**Guideline:** a) We oppose management proposals that seek to approve or create a poison pill. b) We support shareholder proposals that ask a corporation to redeem its poison pill or submit its poison pill for shareholder ratification.

### iii. Fair Price Provisions

**Issue:** Fair price requirements compel anyone acquiring control of a company to pay all shareholders the highest price that the acquirer pays to any shareholder during a specified period of time. Fair price requirements may be included in a company's charter, or in state business incorporation statutes. Fair price requirements are intended to deter two-tier tender offers in which shareholders who tender their shares first receive a higher price for their shares than other shareholders. Fair price provisions are designed to guarantee an equal price for all shareholders and help deter a two-tiered tender offer.

**Guideline:** We support proposals seeking to adopt a fair price provision, as long as the shareholder vote requirement imbedded in the provision is not a supermajority vote.

### iv. Limited Use of and Shareholder Approval of Targeted Share Placements

**Issue:** The issuance of a specific block of company securities to a "friendly" shareholder, a mechanism often used to defend against a hostile takeover or to obtain favorable financing. There is a concern that targeted share placements may prevent a takeover that is supported by the majority of shareholders.

**Guideline:** a) We will consider management proposals seeking the limited use of targeted share placements on a case-by-case basis. b) We support shareholder proposals requesting that a corporation first obtain shareholder authorization of targeted share placements.

## D. Charter and Bylaw Amendments

### i. Charter Amendments (resulting in reduction of shareholders' rights)

**Issue:** Also known as the articles of incorporation, the charter sets forth the respective rights and duties of shareholders, officers, and directors. The charter constitutes the fundamental governing rules for each company. Shareholder approval is required to amend a company's charter. Limitations on any kind of shareholder rights should be avoided.

**Guideline:** We oppose proposals that seek to amend the corporation's certificate of incorporation if an amendment would adversely affect shareholder rights.

### ii. By-Law Changes Requiring a supermajority vote

**Issue:** Bylaws supplement each company's charter, spelling out in more specific detail general provisions contained in the charter. Boards often have the power to change bylaw provisions without shareholder approval. The official rules and regulations which govern a corporation's management. Drawn up at the time of incorporation, along with the charter. This practice is contrary to the principle of (simple) majority rule.

**Guideline:** We oppose proposals that seek to require a supermajority shareholder vote to approve charter and bylaw amendments.