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2007 Proxy Season Preview

Agenda

- Executive Compensation
 - New SEC Executive Compensation Disclosure Rule
 - Shareholder Activism
 - Option Backdating
- Majority Voting to Elect Directors
- Shareholder Access to the Ballot
- International Markets Update
- 2007 Proxy Voting Guideline Revisions

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Executive Compensation

Executive Compensation: SEC Proposal to Improve Executive Compensation Disclosure

- Address concerns that companies may not be disclosing all executive compensation
- Provides a single number representing an executive's total annual compensation
- Recent amendment to rule (12/06): Disclose dollar values of stock awards as tied to compensation cost
 - Likely result in lower amounts disclosed
 - Cost spread out over multiple years

Executive Compensation: SEC Proposal to Improve Executive Compensation Disclosure

- Required additional disclosure
 - Itemize perks if they exceed \$10,000
 - Improve disclosure of retirement benefits
 - New tables outline the defined-benefit and defined-contribution retirement plans of executives
 - Actual payments under golden parachute payments
 - Option grant timing
 - Not require disclosure of specific performance targets if result in competitive harm
- Requires new Compensation Discussion and Analysis section that will include a required explanation of compensation policies
 - Replaces the Compensation Committee Report and performance graph
 - Will be considered filed as soliciting material and therefore subject to CEO/CFO certifications

Executive Compensation: SEC Proposal to Improve Executive Compensation Disclosure

- Retains 3 year compensation table but adds
 - New column with total compensation
 - Dollar value for all stock-based awards
 - Increase in actuarial value of pension plans accrued during the year
 - Earnings on deferred compensation that is not tax-qualified
- Disclose material changes to executive compensation agreements in 8-Ks
- Reorganize and consolidate related-party disclosure rules
 - Negative: increases disclosure threshold for affiliated transactions from \$60k to \$120K
- Reorganize disclosure of director independence and other corporate governance matters
- Require full disclosure of all director compensation

Executive Compensation: Shareholder Initiatives

- Shareholder proposals to require vote on compensation committee report on executive compensation
 - Non-binding
 - Not limit compensation in any way
- Shareholder proposals on disclosure of ties to compensation consultants:
 - Outlining how their compensation committees ensure the independence of consultants who assist in setting the pay packages of top executives to address conflicts
 - Campaign led by a coalition of institutional investors
- Shareholder proposals on golden parachutes
- Shareholder proposals to encourage performance-linked pay

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Option Backdating

Executive Compensation: Option Backdating

- Changing an option's grant date from the actual grant date to an earlier date when the market price of the underlying stock was lower: lower exercise price
- Related practices allowing options to be granted at a lower price either before the release of positive news or following the release of negative news
 - Stock price will move up or down in response to the information
 - Spring-loading: granting stock options while in possession of material, positive information that has not been disclosed publicly
 - Bullet-dodging: delaying the granting of stock options until after the release of material, negative information
- This raises a concern similar to that of insider trading, or the trading on material non-public information

Executive Compensation: Option Backdating

- Glass Lewis tracked 120+ companies implicated to date
- Expect more revelations based on pending investigations
- Identified post-Sox backdating
 - Form 4s supposed to be filed within 2 days of grant
 - Late filing allows backdating

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Shareholder Access to the Ballot

Access to the Ballot

- 2003 SEC proposal went nowhere
- AFSCME shareholder access proposal at AIG in 2005
 - SEC granted no-action relief to AIG to exclude the proposal
 - AFSCME sued AIG, losing at the trial court but winning on appeal
- SEC announced it would amend Rule 14a-8 governing shareholder nominations of directors
- SEC postponed October 18 meeting to December 13, then postponed indefinitely
- Expect some proposals during this window of opportunity

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Majority Voting for Election of Directors

Majority Voting for Election of Directors

- Currently vast majority of companies elect directors using plurality standard
- Shareholders have repeatedly sought a mechanism by which they might have a genuine voice in the election of directors at companies where they hold an interest
- Frustrated by regulatory foot-dragging, shareholders are taking matters into own hands by seeking majority vote standard
- Most of these efforts have centered on regulatory change
 - Latest iteration is the proxy access debate that is stalled at the SEC

Majority Voting for Election of Directors: Amendments to the Model Business Corporation Act

- ABA Committee on Corporate Laws of the Section of Business Law adopted amendments March 13, 2006 to the Model Act to facilitate majority voting in director elections
 - Chaired by E. Norman Veasey, former Chief Justice of the Delaware Supreme Court
 - Model Act is the foundation of corporate law in many states, but not in Delaware
- Left default plurality vote rule in place
 - Concluded that the “failed election” consequences and other concerns made it unwise to change the statutory plurality default rule
 - Concerned since it would apply universally to all corporations governed by state statutes adopting the Model Act provisions
- Amended Model Act to facilitate action by shareholders or directors to adopt bylaws mandating majority voting
- Nominee who fails to receive a majority of the votes cast would serve as a director only until
 - 90 days from the date on which the voting results are determined or
 - Date on which an individual is selected by the board to fill the office held by such director
- ABA Committee also allows corporations to repeal the bylaw provisions of the Model Act
 - Unless originally adopted by stockholders, then only repealed by stockholders

Majority Voting for Election of Directors: Delaware Majority Voting Amendments

- Amendments to the DGCL facilitate majority voting in the election of directors
 - Resignation may be effective upon the occurrence of a future event or events, coupled with authority granted in the same section to make certain resignations irrevocable (*i.e.*, a corporation is permitted to enforce a director's resignation conditioned upon the failure of the director to achieve a specified vote for reelection)
 - Permits a director to resign prior to the occurrence of a specific event (*e.g.*, failure to receive a majority vote) to address the potential fiduciary duty issue surrounding director resignations
 - Bylaw adopted by a vote of stockholders that prescribes the required vote for the election of directors may not be altered or repealed by the board
 - When coupled with board acceptance of director resignation, provisions permit corporations and individual directors to agree voluntarily to voting standards for the election of directors that differ from the DGCL plurality default standard

Majority Voting for Election of Directors: Different Approaches

- Majority vote of voted shares to elect directors
 - Most common shareholder proposal
- Binding proposals
 - 2005: Paychex-defeated by vote of 80% against to 20% in favor
- Majority of outstanding shares to elect directors
 - Longstanding Lockheed Martin approach
- Majority of shares withheld required to unseat a director
- Directors must resign if majority shares withheld
- Directors must resign if votes to withhold exceed votes to elect
 - Pfizer approach

Majority Voting for Election of Directors: **Shareholder concerns with Pfizer approach**

- Still does not require a majority vote to elect
- Still no input into nomination process
- Corporate Governance Committee could reject resignation
- Corporate Governance Committee decides on replacement

Majority Voting for Election of Directors: Statistics

- 147 shareholder proposals in 2006
 - 12 in 2004
 - 89 in 2005
- Average level of support: 44%
 - 12% in 2004
 - 43% in 2005
- 35 proposals received majority vote
 - Highest support at Marriott (96.7%); supported by management
- 150+ companies have some form of majority voting

Majority Voting for Election of Directors: Glass Lewis Approach

- Glass Lewis generally supports majority voting for directors
 - Proposals would allow shareholders to have a voice in determining whether the nominees proposed by the board should actually serve
 - Directors are shareholder representatives and therefore shareholders should have some input into their selection and election
 - Affords a reasonable, minimal amount of protection for shareholders
 - Will not upset the corporate structure
 - Will not reduce the willingness of qualified shareholder-focused directors to serve in the future

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United Kingdom and Canada

David Eaton

Senior International Proxy Research Analyst

Canada – Governance Overview

- No SEC equivalent – each territory and province responsible for own securities regulation
 - Ontario Securities Commission (“OSC”) most influential
- Market rules closely aligned with US governance legislation
- Unique issues
 - Election of directors as a slate
 - Majority independent board, not two-thirds (U.S.)
 - Shareholder rights plans are more common

Canada – Issues for 2007

- TSX Notice (June 2006) re: Stock Option Plans
 - Options which expire during blackout periods
 - Clearly defining which provisions can be amended without shareholder approval

- Option Backdating / Springloading
 - CSA Notice (September) regarding the issue
 - Ontario Securities Commission has launched probe of Research In Motion Ltd.
 - Other companies to be implicated soon?

United Kingdom – Governance Overview

- Financial Services Authority (“FSA”)
 - Regulator of financial services industry
 - Wide range of rule-making, investigatory and enforcement powers

- Primarily based on the Combined Code
 - “Comply or explain” policy

- Typical Issues
 - Non-binding vote on remuneration report
 - Allocation of profits/dividends
 - Authority to issue shares with and without preemptive rights
 - Half of the board, excluding chairman, should be independent

United Kingdom – Issues for 2007

■ Revised Combined Code

- Now allows chairman to serve on remuneration committee
- “Vote withheld” option on proxy appointment forms (in addition to For/Against options)

■ Changes to Companies Act

- All institutional shareholders should disclose how they vote; now voluntary, but expected to become compulsory in near future
- Companies must provide a list of suppliers
- Comprehensive business review including environmental issues and social factors

■ Increased Remuneration Report scrutiny

- Glass Lewis’ updated methodology centered on three areas: disclosure of policies, remuneration structure, and quantum

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Europe

Carla Topino

Senior International Proxy Research Analyst

Europe: Recent Developments in the EU

- European Commission Proposal for a Directive on the exercise of shareholders' voting rights
- European Corporate Governance Forum: Cross-border exercise of shareholders' rights
- Future priorities for the Action Plan on Company Law and Corporate Governance

Germany

- Takeover Directive Implementation Act
 - Disclosure of information on existing defense mechanisms

- Transparency Directive Implementation Act
 - Financial statement certifications and interim management statements

- Shareholders' Activism
 - Siemens AG and ThyssenKrupp AG

Scandinavia

- **Finland:** *New Finnish Companies Act (Law 624/2006)*
 - Non par value system
 - Solvency test to be applied in connection with the distribution of funds
 - Possibility for three-party mergers

- **Sweden:** *Compliance with Corporate Governance Code*
 - Approval of remuneration policies by shareholders
 - Election of nominating committees

The Netherlands

- Disclosure Act 2006
 - Issuer's obligation to notify changes in share capital and voting rights
 - Notification of interests held by shareholders, management and supervisory boards

- Compliance with Corporate Governance Code
 - Approval of remuneration policies by shareholders
 - Issuance of protective preference shares as anti-takeover device

France

- Amended Decree No. 67-236
 - Elimination of share-blocking
 - Improvement of shareholders' right to participate at meetings
 - New time limits on meeting procedures

Italy

■ Law 303/2006:

- Number of independent directors
- Voting list system for board elections
- Appointment of independent auditor for a nine-year term

■ New Corporate Governance Code:

- Independence requirements for board committees
- Lead independent director

■ Dualistic Governance System vs. Traditional Model:

- Increased popularity of supervisory boards among merged entities

The logo for Glass Lewis & Co. is displayed in white text on a blue rectangular background. The text is arranged in two lines: "GLASS" on the top line and "LEWIS & Co." on the bottom line. The font is a classic serif typeface.

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Latin America

Nichol Garzon

Senior International Proxy Research Analyst

Brazil

- *Novo Mercado* Regulations (February 6, 2006)
 - 25% minimum free float
 - 2 year term limit for board
 - 20% independence rule for board
 - Mandatory disclosure of financial statements
 - Stricter compliance (tender offers and trades by controlling shareholder)

- Effects
 - Delayed timing
 - Implementation of new rules and regulations
 - Continued transition

Mexico

- Mexican Securities Market Law (July 1, 2006)
 - 25% independence rule for board
 - Establishment of audit and corporate governance committees
 - Replacement of *comisario* with independent external auditor

- Effects
 - Amendments to articles
 - Removal of directors
 - Appointment of independent external auditor

Colombia

■ Legislative Initiatives - Code of Best Practices

- *Superintendencia Financiera*
- Harmonize unofficial codes
- Create single enforceable document

■ Key Regulations

- Proxy materials 15 days before AGM
- 25% independence rule for board
- Independent audit committee

New Challenges Facing Latin America

- Enforcement
- Lack of transparency
- Inadequate disclosure
- Excessive ownership concentration
- Low board independence standards

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Asia

Jun Frank

Senior International Proxy Research Analyst

Asian Corporate Governance - Overview

- Two Types of Governance Structures
 - UK-style governance and German/Japanese style governance
 - China, mix of both structures

- Behind Euro-American Markets
 - Poor disclosure, lower board independence and limited shareholder rights
 - Singapore and Hong Kong, similar to UK

- Various Recent Improvements
 - Revision to China's company law
 - Singapore's amended Commercial Act and revised Code of Corporate Governance

Korea – Chaebol Reform

■ Chaebol

- Korean conglomerates
- Often controlled by complex web of cross shareholding: Samsung, Hyundai, Doosan

■ Problems Facing Chaebol

- Lack of transparency and accountability
- Conflict of interests between management and investors
- Recent increase in shareholder activism: SK Corp and KT&G
- Threat of hostile takeover

Korea – Chaebol Reform

- Revised Financial Industry Restructuring Law
 - Limits shareholding of financial companies in non-financial affiliates
 - Targeted Samsung Group – Shares in non-financial affiliates will be sold or voting rights will be frozen
- Proposed Amendments to the Competition Law
 - Changing the cap on cross shareholding (allowing greater investment while affecting larger number of companies)
 - Tightening regulations on related party transactions
 - Banning new circular cross shareholding
- Proposed Amendments to the Commercial Code
 - Double derivative lawsuit system
 - Separation of roles of management and board
 - Electronic voting system

Other Developments in Asia

■ China

- “A Share” reform
- IPO and “A Share” listing

■ Thailand

- Political uncertainty
- Alleged corruption
- Board reshuffle in government-affiliated entities

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Guideline Revisions for 2007

New Guideline Provisions for 2007

■ Option Backdating

- Withhold for compensation committee members serving at time of backdating
- Consider withholding for audit committee members if resulted in restatement and/or lack of controls

■ Clawbacks

- Will generally support shareholder proposals seeking management recoup bonuses following restatement
 - Unless company has policy in place already
 - Glass Lewis will examine if clawback language included in executive contracts

Adjustments to Guideline Provisions for 2007

- Raised thresholds for directors related transactions from \$25,000 to \$50,000
- Reduced number of additional board seats for executives
 - 3 board seats including company where executive works
 - Eliminated distinction between CEOs and other executives
- Administrative
 - Removed reference to option expensing
 - Clarified provisions relating to audit committee treatment

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Final Considerations

New Congress

- Likely to review Sarbanes-Oxley, less chance of large scale rollback than under Republicans
- With Barney Frank in charge of House Financial Services Committee, taking over from Michael Oxley
 - Push advisory votes on compensation
 - Expected to hold hearings on executive compensation
- Majority voting and access to ballot more likely to get congressional support
- Senate proposed raising taxes on executive compensation
 - Cap at \$1 million amount employee may place in tax deferred compensation plans annually
 - Limit deduction companies take for executives who leave the company during the year



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Questions?