PROXY PAPER™

GUIDELINES

2016 PROXY SEASON

AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE

JAPAN

GLASS LEWIS

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Guidelines Introduction

REGULATORY AND CORPORATE GOVERNANCE BACKGROUND

Japan has traditionally adhered to poor corporate governance standards, which has presented a significant challenge for shareholders during the proxy season. Common themes are the lack of board independence, concentrated meeting dates, late proxy material distribution, poor disclosure practices and the necessity for manual procurement of information.

Japanese corporate governance is centered primarily on the Companies Act, the Financial Instruments and Exchange Act, the Tokyo Stock Exchange (“TSE”) Listing Rules (“Listing Rules”) and Japan’s Corporate Governance Code (“Code”).

The Companies Act and the Listing Rules provide the primary legislative framework for Japanese corporate governance. Best practices are centered on the recommendations contained in the Code, which operates on a comply-or-explain basis, whereby the publicly listed companies[1] are required to submit statements detailing their adherence to the Code to TSE.

The Companies Act was most recently amended and took effect on May 1, 2015 and the Code was adopted on June 1, 2015.

SUMMARY OF CHANGES FOR THE 2016 JAPAN POLICY GUIDELINES

The new changes for the 2016 policy guidelines are summarized below. These changes are discussed in further detail in each relevant section.

GLASS LEWIS STANDARDS FOR ASSESSING “MATERIAL” TRANSACTIONS WITH DIRECTORS

We have revised our threshold for assessing material transactions with directors in regard to professional services, charitable contributions and other services. Under the new standards, we will consider the transaction as material if the transaction value exceeds:

- ¥5,000,000 (or where no amount is disclosed) for directors who are paid for a service they have agreed to perform for the company, outside of their service as a director, including professional or other services; or
- ¥12,000,000 (or where no amount is disclosed) for directors employed by a professional services firm such as a law firm, investment bank, or consulting firm, where the company pays the firm, not the individual, for services. In addition, we may deem such a transaction to be material where the amount represents more than 1% of the firm’s annual revenues and the board does not provide a compelling rationale as to why the director’s independence is not affected by the relationship. This value limit would also apply to charitable contributions to schools where a board member is a professor; or charities where a director serves on the board or is an executive.

1 The Code will apply to all companies listed on the Tokyo Stock Exchange (“TSE”) and other stock exchange in Japan. However, companies listed on other than TSE First and Second Sections will only need to explain any non-compliance with the General Principle of the Code.

I. A Governance Structure that Serves Shareholder Interest

ELECTION OF BOARD OF DIRECTORS

The purpose of Glass Lewis' proxy research and advice is to facilitate shareholder voting in favor of governance structures that will drive performance, create shareholder value and maintain a proper tone at the top. Glass Lewis looks for talented boards with a record of protecting shareholders and delivering value over the medium- and long-term. We believe that boards working to protect and enhance the best interests of shareholders are independent, have a record of positive performance and have members with a breadth and depth of experience.

BOARD INDEPENDENCE

The independence of directors, or lack thereof, is ultimately demonstrated through the decisions they make. In assessing the independence of directors, we will take into consideration, when appropriate, whether a director has a track record indicative of making objective decisions. We will also look at the other boards the director may sit, if any, and his/her conducts. Ultimately, our determination of a director's independence must take into consideration both compliance with the applicable independence listing requirements and past decisions.

We look at each director nominee to examine his/her relationships with the company, the company's executives and other directors. We do this research to find personal, familial or financial relationships (other than director compensation) that may impact the director's decisions. We believe that such relationships make it difficult for a director to put shareholders' interests above those of the director or a related party. We also believe that a director who owns more than 10% of a company can exert disproportionate influence on the board.

Thus, we put directors into three categories based on an examination of the type of relationship they have with the company:

Independent Director – Glass Lewis considers an outside director independent[2] if we find no evidence of material, financial, familial or other current relationships with the company,[3] its executives,[4] other board members or shareholders holding 10% or more of the company's voting common stock or major lenders.

Affiliated Director[5] – An affiliated director is an outside director who has a material financial, familial or other relationship with the company or its executives but is not an employee of the company.[6] This includes directors whose employers have a material financial relationship with the company, as well as any director who owns or controls 10% or more of the company's voting stock. In addition, if we find evidence of cross-shareholding relationships, we will consider insiders and affiliates of such arrangements not independent.

Glass Lewis applies a three-year look back period to all directors who have an affiliation with the company other than former employment, for which we apply a five-year look back. Where the timing of the cessation of a relationship is not disclosed, as a general rule we treat such relationship as recent.

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2 The Companies Act prohibits a judicial person who controls the management of the company ("Parent Company") or a director, executive or employee of the Parent Company or spouses and relatives within two degrees of kinship of the Parent Company to be considered outsiders. Further, pursuant to the Listing Rules, a director and/or statutory auditor can be classified as independent if the individual (i) has never been an executive of the company's Parent Company, sister companies or major business affiliates; (ii) does not receive significant monetary benefits from the company for professional services rendered, apart from his/her service as a board member; (iii) does not hold significant equity stake in the company; or (iv) is not a relative of the company's executives, its affiliates, major shareholders or professional services providers.

3 "Company" includes any parent or subsidiary in a consolidated group with the company or any entity that merged with, was acquired by, or acquired the company.

4 However, former executives can be considered an outsider if 10 years have passed since the termination of their service from the company.

5 In every instance in which a company classifies one of its directors as non-independent, that director will be classified as an affiliate by Glass Lewis.

6 If a company classifies a director as an outsider and no details regarding the director are disclosed, Glass Lewis classifies the director as an "outsider" and refrains from classifying the director as either independent or an affiliate.

Definition of "Material": A material relationship is one in which the dollar value exceeds:

- ¥5,000,000 (or where no amount is disclosed) for directors who are paid for a service they have agreed to perform for the company, outside of their service as a director, including professional or other services;
- ¥12,000,000 (or where no amount is disclosed) for directors employed by a professional services firm such as a law firm, investment bank, or consulting firm, where the company pays the firm, not the individual, for services. In addition, we may deem such a transaction to be material where the amount represents more than 1% of the firm's annual revenues and the board does not provide a compelling rationale as to why the director's independence is not affected by the relationship. This value limit would also apply to charitable contributions to schools where a board member is a professor; or charities where a director serves on the board or is an executive; or
- 1% of either company's consolidated gross revenue for other business relationships (e.g., where the director is an executive officer of a company that provides services or products to or receives services or products from the company).

Inside Director – An inside director is someone who serves as a director and is or has been a full-time director, executive or employee of the company or any of its subsidiaries. This category may include a chairman of the board who acts as an employee of the company or is paid as an employee of the company.[7]

JAPANESE BOARD STRUCTURES

Under the Companies Act, there are three types of board structures: (i) two-tier board with statutory auditor board; (ii) one-tier board with three committees; and (iii) one-tier board with one committee.

Types of Japanese Board Structures

	Two-Tier Board with Statutory Auditor ("SA") Board	One-Tier Board with Three Committees	One-Tier Board with One Committee
Committee or SA Board	SA Board	Audit, nominating and compensation committees	Only audit committee
Minimum Requirement for SA Board or Committee by the Companies Act	Minimum of 3 SAs (50% of whom must be outside SAs)	Minimum of 3 directors (Majority of whom must be outside directors)	Minimum of 3 directors (Majority of whom must be outside directors)
Best Practice	2 independent outside directors	2 independent outside directors	2 independent outside directors

VOTING RECOMMENDATIONS ON THE BASIS OF BOARD INDEPENDENCE

- Two-Tier Board – Board of Directors

  We believe that a board will most effectively perform the oversight necessary to protect the interests of shareholders if it has a sufficient level of independence. While we strongly believe that a substantial portion of a board should consist of independent directors, we understand that it is a common Japanese practice for boards to have minimal independent representation. Therefore, recommending a level of independence that far exceeds the market standard may not be effective in convincing Japanese boards to adopt governance structures that better protect shareholder interests. We therefore believe that shareholders should demand a basic level of independence that serves as a minimal safeguard of shareholder rights.

  To this end, we believe that a board should have: (i) at least two independent outside directors; or (ii) 20% independence representation, whichever is higher. If a board does not meet this minimal

7 When a director is not classified as an outsider or independent, we will classify him/her as an insider. We will also apply the definition of insider when classifying a director.

independence threshold, we will recommend shareholders vote against the re-election of the chairman of the board. When the position of chairman does not exist, we will hold the most senior member of the board – including the chief executive – accountable for this issue.[8]

We will, however, always review a board's independence on a case-by-case basis and, where justified, we may make exceptions to our general rule. We are of the view that no single model of governance is ideal for all listed entities, and so we encourage issuers to explain their system of corporate governance and how it will be effective in protecting and promoting shareholder value.

- Two-Tier Board – Board of Statutory Auditors[9]

  The Companies Act requires that corporations over a certain size[10] have a minimum of three statutory auditors, at least one of whom must be full-time, and at least half of this group must consist of external statutory auditors.[11] Also, a statutory auditor may not serve concurrently as a director of the company. Given the important role that statutory auditors play, we believe that a majority should be independent, external statutory auditors who are free of any material, financial, familial or other affiliations that may cause conflicts of interest.

  When evaluating the independence of a statutory auditor, we apply the same standards as we do in reviewing director independence. Should we find any evidence that may bring into question the independence of an external statutory auditor, we will consider that statutory auditor to be non-independent. If a board does not have a sufficient level of independence representation, we will recommend voting against the necessary number of candidates in order to satisfy the independence level we believe is minimally necessary. We also strongly discourage the practice of insiders serving on this board as the primarily responsibility of the board of statutory auditor is the oversight of the board of directors.

  We believe that holders of more than 20% of a company's stock are not independent because their interests and financial needs may differ from other shareholders. We believe that the area of financial disclosure is critical to shareholders. Any potential conflict between a statutory auditor's own interests and those of shareholders should be strictly monitored as the board of statutory auditors oversees accounting and disclosure. As such, we will recommend voting against any statutory auditors who owns at least 20% of the company's stock or is affiliated with a substantial shareholder that owns at least 20% of the company's stock.

- One-Tier Board with Three Committees

  We believe that for companies that have adopted a one-tier board with three committee structure, at least one-third of the board should be independent. In the event that less than one-third of the directors are independent, we typically recommend voting against the necessary number of inside directors or affiliates in order to satisfy the level of independence we believe is appropriate. In addition, we will hold the chairman of the nominating committee accountable for the lack of board independence.

- One-Tier Board with One Committee

  We believe that for companies that have adopted a one-tier board with one committee structure, at least one-third of the board should be independent. In the event that less than one-third of the directors are independent, we generally recommend voting against the necessary number of inside directors or affiliates in order to satisfy the level of independence we believe is appropriate. In addition, we will hold the chairman of the board (or CEO in the absence of chairman) accountable for the lack of board independence.

8 In Japan, the chief executive, or its equivalent, often functions as the de facto chairman and exerts substantial influence over a board's decision-making.

9 Although the board of statutory auditors has a similar function to an audit committee in the U.S., according to the Companies Act, the main responsibility of a statutory auditor is to audit the execution of directors' duties.

10 A large company is defined by the Companies Act as a company having legal capital of ¥500 million or more, or total balance-sheet liabilities of ¥20 billion or more.

11 Under the Companies Act, an external statutory auditor is defined as an auditor who has never been a director, officer or employee of the company or any of its subsidiaries.

NO INDEPENDENCE EXCEPTIONS FOR CONTROLLED COMPANIES

- Board of Directors

  The board's function is to protect shareholder interests; however, when an individual or entity owns more than 50% of the voting shares, the interests of the majority of shareholders are the interests of that entity or individual. That said, Japanese boards are often dominated by insiders. While we may make exceptions to our policies for a few controlled companies on a case by case basis, given the unique nature of the traditional board structure of Japanese companies, Glass Lewis believes that minimal independence even at controlled companies is essential in making sure that minority shareholders' interests are protected. In general, we therefore do not make any board independence exceptions for controlled companies.

- Audit Committee and Board of Statutory Auditors

  We do not make independence exceptions for audit committee membership and the board of statutory auditors at controlled companies. Audit committees and the board of statutory auditors should be majority independent. Regardless of a company's controlled status, the interests of all shareholders must be protected by ensuring the integrity and accuracy of the company's financial statements. Allowing insiders and affiliates to discharge the duties of audit oversight could present an insurmountable conflict of interest.

PERFORMANCE

Director Performance

The most crucial test of a board's commitment to the company and its shareholders lies in the actions of the board and its members. We look at the performance of the directors and executives at the subject company, as well as other companies where they have served.

Voting Recommendations on the Basis of Director Performance

We disfavor directors who have a track record of poor performance in fulfilling their responsibilities to shareholders as a director or executive. We typically recommend voting against:

- A director who is also the chief executive, or who holds an equivalent position,[12] of a company where a serious restatement has occurred after the chief executive certified the pre-restatement financial statements.
- All members of the board when a company's performance has been consistently worse than its peers and the board has not taken reasonable steps to address the poor performance.[13]
- The chairman of the board if the company adopted a takeover defense measure without shareholder approval within the last 12 months, and where such adoption is not presented to shareholders for ratification. In the absence of the chairman, we will recommend shareholders vote against the re-election of the chief executive officer.

Statutory Auditor Performance

Japanese companies are not required to seek shareholder approval of the appointment of auditors. Should we find any concern regarding the independence of an auditor, and the appointment of the auditor has not been presented for shareholder approval, we will recommend voting against the statutory auditors whom we believe are responsible for the appointment of the problematic auditor.

In addition, under the 2004 Revised Certified Public Accountants Law, accountants are prohibited from auditing the same company for more than seven consecutive years, commencing from the year of enforcement. Under

12 The president of a company usually has similar authority and duties as the CEO.

13 In accordance with the proxy voting principles of the Japan Pension Fund Association, we may consider voting against all directors who are up for re-election when shareholder value is obviously impaired because the company is operating at a loss and has not paid dividends for the past three consecutive fiscal years, including the current fiscal year, or has aggregated current losses for the past five fiscal years.

this law, only the individual accountants, not the firm, are prohibited from continuing to audit a company for more than seven years.

Voting Recommendations on the Basis of Statutory Auditor Performance

We will recommend voting against certain proposed statutory auditors in the following cases:

- Statutory auditors who are up for election and served on the board at the time of the audit, if audit and audit-related fees total less than 50% of overall fees billed by the auditor.[14]
- All statutory auditors if non-audit fees include fees for tax services for senior executives of the company or involve services related to tax avoidance or tax shelter schemes.
- Statutory auditors who re-appointed an auditor that we no longer consider to be independent for reasons unrelated to fee proportions.
- Statutory auditors who served at a time when accounting fraud occurred in the company.
- Statutory auditors who served at a time when financial statements had to be restated due to negligence or fraud.
- All statutory auditors if the company has repeatedly failed to file its financial reports in a timely fashion.
- All statutory auditors if the company has failed to report or to have its auditors report material weaknesses in internal controls.
- The entire board of statutory auditors if the statutory auditor board did not meet at least four times during the year.

Director and Statutory Auditor Attendance

We note that Japanese laws and regulations require public companies to disclose board meetings attendance only of outside directors and external statutory auditors but not the attendance records of insiders. We believe that attendance at board meetings is one of the fundamental responsibilities of a board member, and that all directors and statutory auditors should attend meetings regularly to review the company's performance and ensure the protection of shareholder interests.

In Japan, companies typically hold board meetings on a monthly basis, if not more frequently, which may make it burdensome for outsiders to attend all board meeting. We are concerned that voting against outside directors and statutory auditors for failing to attend such frequent board meetings may unfairly punish outside board members. However, outside board members are still a small minority on Japanese boards and given the important role that they play, their attendance at board meetings is crucial. Accordingly, if a director or statutory auditors fails to attend a minimum of 75% of the board meetings or 75% of the total applicable committees, we will recommend voting against him/her.[15]

EXPERIENCE

We believe that boards should have diverse backgrounds and members with a breadth and depth of relevant experience. We believe that the board or the nominating committee should consider diversity when making director nominations within the context of each specific company and its industry. In our view, shareholders are best served when boards make an effort to ensure a constituency that is not only reasonably diverse on the basis of age, race, gender and ethnicity, but also on the basis of geographic knowledge, industry experience, board tenure and culture. In addition, we believe that at least one of the outside directors should have relevant industry experience.

We find that a director's past is often indicative of future conduct and performance. We often find directors with a history of overpaying executives or of serving on boards where avoidable disasters have occurred appearing at companies that follow these same patterns. Glass Lewis has a proprietary database that tracks the performance

14 In Japan, the breakdown of audit fees versus non-audit fees is rarely disclosed.

15 However, where a director or statutory auditor has served for less than one full year, we will not typically recommend voting against him for failure to attend 75% of meetings. Rather, we will note the failure with a recommendation to track this issue going forward. We will also refrain from voting against directors or statutory auditors when the proxy discloses that the director missed the meetings due to serious illness or other reasonable extenuating circumstances.

of directors across companies worldwide and will recommend voting against such problematic directors at all companies where they serve.

Voting Recommendations on the Basis of Experience

We typically recommend that shareholders vote against directors who have served on boards or as executives of companies with a track record of poor performance, overcompensation, audit-or accounting-related issues and/or other indicators of mismanagement or actions against the interests of shareholders.[16]

Similarly, we look carefully at the backgrounds of those who serve on the key committees of the board to ensure that they have the required skills and diverse backgrounds to make informed and well-reasoned judgments about the subject matter for which the committee is responsible.

CONFLICTS OF INTEREST

In addition to the three key characteristics described above – independence, performance and experience – that we use to evaluate board members, we consider conflict-of-interest issues in making our voting recommendations.

We believe that a board should be wholly free of people who have an identifiable and substantial conflict of interest, regardless of the overall presence of independent directors on the board. Accordingly, we recommend that shareholders vote against the following types of affiliated or inside directors/statutory auditors:

- **Excessive directorship**: A board member who is on an excessive number of boards: Glass Lewis typically recommends shareholders vote against a director who serves as an executive officer of any public company while serving on more than four other public company boards, and any other director who serves on more than six other public company boards. However, we will generally refrain from recommending voting against directors at companies where they also serve as CEO, executive chairperson, or a combined CEO-executive chairperson, since a vote against such top executive may be interpreted as an indication of loss of confidence in the executive when the real concern is the executive's over-commitment of other board seats outside the executive role. In addition, the recruitment and retention of top executives is fundamentally different than that for a director, making turnover in a company's executive ranks a significantly more material change than among the board. Further, given an executive's role and knowledge of the company where he or she serves as top executive, the additional time demands for that board seat are significantly less than for other boards.
- **Professional services**: A board member who provides consulting or other material professional services to the company, or who has an immediate family member who provides such services: These services may include legal, consulting, or financial services. We question the need for the company to have consulting relationships with its board members. We view such relationships as creating conflicts for directors and statutory auditors, since they may be forced to weigh their own interests against those of shareholders when making board decisions. In addition, a company's decisions regarding where to turn for the best professional services may be compromised when doing business with the professional services firm of one of the company's board members. However, if we find the monetary value of the relationship to be non-material, we will refrain from making voting recommendations on this basis.[17]
- **Business transactions**: A board member who is affiliated with an entity that has business transactions with the Company worth more than 1% of either company's consolidated gross revenue. We question the need for the Company to engage in business relationships with its directors. We view such relationships as potentially creating conflicts for directors, as they may be forced to weigh their own interests in relation to shareholder interests when making board decisions. In addition, a company's decision regarding

16 We typically apply a three-year look-back period to such issues.

17 A non-material relationship is one in which the dollar value is less than ¥5,000,000 (or if no amount is disclosed) for directors who are paid for a service they have agreed to perform for the company, outside their service as a director, including professional or other services; or (ii) ¥12,000,000 (or if no amount is disclosed) for those directors employed by a professional services firm, such as a law firm, investment bank, or consulting firm and the company pays the firm, not the individual, for services. This value limit would also apply to charitable contributions to schools where a board member is a professor; or charities where a director serves on the board or is an executive.

where to turn for the best products and services may be compromised when doing business with the firm of one of the company's directors. However, if we find the monetary value of the relationship to be non-material, we will refrain from making voting recommendations on this basis.

- **Interlocking directorships**: Chief executives or other top executives who serve, or have served within the past three years, on each other's boards create an interlock that poses conflicts that should be avoided to ensure the promotion of shareholder interests above all else.

BOARD SIZE

While we do not believe that there is a universally applicable optimum board size, we do believe that boards should have at least five directors to ensure sufficient diversity in decision-making and enable the formation of key board committees with independent directors. Conversely, we believe that boards with more than 20 members will typically suffer under the weight of "too many cooks in the kitchen" and have difficulty reaching consensus and making timely decisions. Sometimes the presence of too many voices makes it difficult to draw on the wisdom and experience in the room by virtue of the need to limit the discussion so that each voice may be heard.

To that end, we typically recommend voting against the chairman of the nominating committee[18] if a board has fewer than five directors or more than 20.

DECLASSIFIED BOARDS

Under the Companies Act, directors at firms with a two-tier board structure shall have terms of office of no more than two years; for one-tier boards with three committee structure, such terms shall be no more than one year. In addition, as for companies with one-tier board with one committee, a director who serves as an audit committee member will have a term of two years while a director who does not serve as an audit committee member will be limited to a term of one year.

Glass Lewis favors the elimination of staggered boards in favor of the annual election of directors. We believe staggered boards are less accountable to shareholders than boards that are elected annually. Furthermore, we feel the annual election of directors encourages board members to focus on shareholder interests. Moreover, empirical studies have shown: (i) companies with staggered boards reduce a firm's value; and (ii) in the context of hostile takeovers, staggered boards operate as a takeover defense, which entrenches management, discourages potential acquirers and delivers a lower return to target shareholders.

Given the empirical evidence suggesting staggered boards reduce a company's value and the increasing shareholder opposition to such a structure, Glass Lewis supports the declassification of boards and the annual election of directors.

TERM AND AGE LIMITS

Glass Lewis believes that director age and term limits typically are not in shareholders' best interests. Too often age and term limits are used by boards as a crutch to remove board members who have served for an extended period of time. When used in that fashion, such limits are indicative of a board that has a difficult time making "tough decisions."

Academic literature suggests that there is no evidence of a correlation between director performance and either length of tenure or age. On occasion, term limits can be used as a means to remove a director from boards that are unwilling to directly police their membership and enforce turnover. Some shareholders support term limits as a way to force change when boards are unwilling to do so.

While we understand age limits can be a way to force change when boards are unwilling to make changes on their own, the long-term impact of age limits restricts experienced and potentially valuable board members from service through arbitrary means. Further, age limits unfairly imply that older (or, in rare cases, younger) directors cannot contribute to company oversight. A director's experience can be valuable to shareholders because directors navigate complex and critical issues when serving on a board.

18 In the absence of a nominating committee, we will recommend voting against the chairman of the board.

In our view, a director's experience can be a valuable asset to shareholders because of the complex, critical issues that boards face. However, we support periodic director rotation to ensure a fresh perspective in the boardroom and the generation of new ideas and business strategies. We believe boards should implement such rotation instead of relying on arbitrary limits. When necessary, shareholders can address the issue of rotation through director elections.

We believe that shareholders are better off monitoring a board's approach to corporate governance and its stewardship of company performance, rather than imposing inflexible rules that do not necessarily correlate with returns or benefits for shareholders.

However, if a board adopts term/age limits, it should follow through and not waive such limits. If the board waives its term/age limits, Glass Lewis will consider recommending shareholders withhold votes from the nominating and/or governance committees, unless the rule was waived with a reasonable explanation, such as the consummation of a major corporate transaction.

SEPARATION OF THE ROLES OF CHAIRMAN AND CEO

In Japan, the Companies Act does not require the separation of the roles of chairman and CEO/president. At a company that adopts a two-tier board structure, the board of directors appoints representative director(s) from amongst themselves. In a company that adopts a committee-system-type board structure, the board appoints: (i) executive officers who run the day-to-day business of the company; and (ii) the representative executive officers, who represent the company and can legally bind it. Customarily, one of the representative directors is the president. The position of chairman is often absent in Japanese boards and, when present, the position is generally more ceremonial than of practical significance. The chairman usually, but not always, has the authority to represent the company.

Glass Lewis believes that separating the roles of chief executive officer and chairman creates a better governance structure than a combined executive/chairman position. An executive manages the business according to a course the board charts. Executives should report to the board regarding their performance in achieving goals set by the board. This process is needlessly complicated when a CEO sits on or chairs the board, as a CEO presumably will have a significant influence over the board.

It can become difficult for a board to fulfill its role of overseer and policy-setter when a CEO/chairman controls the agenda and the boardroom discussion. Such power can allow a CEO to have an entrenched position, leading to longer-than-optimal terms, fewer checks on management, less scrutiny of the business operation and limitations on independent, shareholder-focused goal-setting by the board.

A CEO should set the strategic course for a company, with the board's approval, and the board should enable the CEO to carry out the CEO's vision for accomplishing the board's objectives. The failure to achieve the board's objectives should lead it to replace that CEO with someone in whom the directors have more confidence.

Similarly, an independent chairman can better oversee executives and set a pro-shareholder agenda without the management conflicts that a CEO or other executive insider often faces. Such oversight and concern for shareholders allows for a more proactive and effective board of directors that is better able to look out for the interests of shareholders.

We do not recommend that shareholders vote against CEOs who serve on or chair the board. However, we typically encourage our clients to support separating the roles of chairman and CEO whenever that question is posed in a proxy (typically in the form of a shareholder proposal, although this would be rare at a Japanese company), as we believe that it is in the long-term best interests of the company and its shareholders.

Glass Lewis strongly supports the existence of a presiding or lead director with the authority to set the agenda for the meetings and lead sessions outside the presence of the insider chairman.

BOARD COMMITTEES (APPLIES TO ONE-TIER BOARD WITH THREE COMMITTEES AND ONE-TIER BOARD WITH ONE COMMITTEE)[19]

COMMITTEE INDEPENDENCE

The Companies Act stipulates that, for firms with a one-tier board with three committees, each of the audit, nominating and compensation committees should consist of three or more directors, a majority of whom should be outside directors.[20] We believe that a majority of the members of each of these committees should be independent outside directors.[21] We will also apply this standard to the audit committee of a one-tier board with one committee.

We typically recommend that shareholders vote against inside and/or affiliated directors seeking appointment to an audit, compensation or nominating committee when the committee is not comprised of a majority of independent directors.

We also believe the chair of the audit committee should be an independent director. In addition, we believe that holders of more than 20% of a company's stock are not independent because their interests and financial needs may differ from other shareholders. Financial disclosure is critical to shareholders, and any potential conflict between a director's own interests and those of shareholders should be strictly monitored. Therefore, we believe substantial shareholders should not serve on the audit committee. As such, we will recommend voting against any member of audit committee who owns at least 20% of the company's stock or is affiliated with a substantial shareholder that owns at least 20% of the company's stock.

While we recognize there will be some participation by insiders on the compensation committee, we do not believe that the CEO or other top executives should chair the compensation committee. It is crucial for the compensation committee to be in the position of reviewing, evaluating and linking executive performance and pay. In particular, the compensation committee should ensure that the CEO's compensation reflects the company's performance, in addition to individual performance, and that the CEO's compensation program is designed to maximize shareholder value. This oversight is likely more complicated and less rigorous when the CEO chairs the committee that determines his/her compensation. Accordingly, we generally recommend shareholders vote against the election of a CEO who chairs the compensation committee. Additionally, we will recommend against the election of a CEO even if he/she serves as a member when the committee is chaired by a less senior executive, as we believe the CEO will have substantial influence over determining his/her own compensation.

AUDIT COMMITTEE PERFORMANCE

Audit committees play an integral role in overseeing the financial reporting process because "[v]ibrant and stable capital markets depend on, among other things, reliable, transparent and objective financial information to support an efficient and effective capital market process. The vital oversight role audit committees play in the process of producing financial information has never been more important."[22]

When assessing an audit committee's performance, we are aware that an audit committee does not prepare financial statements, is not responsible for making the key judgments and assumptions that affect the financial statements, and does not audit the numbers or the disclosures provided to investors. Rather, an audit committee member monitors and oversees the process and procedures that management and auditors perform. The 1999 Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees stated it best:

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19 If our recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered, we will express our concern regarding the committee chair and recommend voting against this individual as appropriate in the next election. In all cases, if the chair of the committee is not specified, but our policy calls for voting against the committee chair, we will recommend voting against the director who has been on the committee the longest as the de facto chair.

20 Article 400 of the Companies Act.

21 If the company fails to disclose the details regarding the committee membership and composition, we will recommend shareholders hold the chairman of the board accountable for the failure to disclose relevant information.

22 "Audit Committee Effectiveness – What Works Best." PricewaterhouseCoopers. The Institute of Internal Auditors Research Foundation. 2005.

A proper and well-functioning system exists, therefore, when the three main groups responsible for financial reporting – the full board including the audit committee, financial management including the internal auditors, and the outside auditors – form a "three-legged stool" that supports responsible financial disclosure and active participatory oversight. However, in the view of [this committee], the audit committee must be "first among equals" in this process, since the audit committee is an extension of the full board and hence the ultimate monitor of the process. For an audit committee to function effectively on investors' behalf, it must include members with sufficient knowledge to diligently carry out its responsibilities. In its audit and accounting recommendations, the Conference Board Commission on Public Trust and Private Enterprise said "members of the audit committee must be independent and have both knowledge and experience in auditing financial matters."[23]

We are skeptical of audit committees where there are members that lack expertise in finance and accounting, or in any other equivalent or similar areas of expertise. While we will not necessarily recommend voting against members of an audit committee when such expertise is lacking, we are more likely to vote against committee members when a problem such as a restatement occurs and such expertise is lacking.

Glass Lewis generally assesses audit committees by reviewing the decisions they make with respect to their oversight and monitoring role. The quality and integrity of the financial statements and earnings reports, the completeness of disclosures necessary for investors to make informed decisions and the effectiveness of the internal controls should provide reasonable assurance that the financial statements are materially free from errors. The independence of the external auditors and the results of their work all provide useful information by which to assess the audit committee.

When assessing the decisions and actions of the audit committee, we typically defer to its judgment and vote in favor of its members, but we would recommend voting against the following members under the following circumstances:[24]

- All members of an audit committee who are up for election and who served on the committee at the time of the audit, if audit and audit-related fees total less than 50% of overall fees billed by the auditor.
- All members of an audit committee if non-audit fees include fees for tax services for senior executives of the company or involve services related to tax avoidance or tax shelter schemes.
- All members of an audit committee that re-appointed an auditor that we no longer consider to be independent for reasons unrelated to fee proportions.
- All members of an audit committee who served at a time when accounting fraud occurred in the company.
- All members of an audit committee who served at a time when financial statements had to be restated due to negligence or fraud.
- All members of an audit committee if the company has repeatedly failed to file its financial reports in a timely fashion.
- All members of an audit committee at a time when the company fails to report, or to have its auditors report, material weaknesses in internal controls.
- The audit committee chair if the committee has less than three members.
- The audit committee chair if the committee did not meet at least four times during the year.

We also take a dim view of audit committee reports that consist of boilerplate language and provide little or no information or transparency to investors. When a certain type of problem occurs, such as a material weakness, restatement or late filing, our judgment of the audit committee's performance takes into account the transparency of the audit committee report.

23 Commission on Public Trust and Private Enterprise. The Conference Board. 2003.

24 If our recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will express our concern regarding the committee chair. In the absence of an audit committee, we will recommend voting against the chairman of the board.

COMPENSATION COMMITTEE PERFORMANCE

Compensation committees have the final say in determining the compensation of executives. This includes deciding the bases on which compensation is determined, as well as the amounts and types of compensation to be paid. This process begins with the hiring and initial establishment of employment agreements, including the terms for such items as base pay, pensions and severance arrangements. It is important that compensation be consistent with, and based on, the long-term economic performance of the company's long-term shareholder returns.

Compensation committees are also responsible for the oversight of the transparency of compensation packages. This oversight includes the disclosure of compensation arrangements, the matrices used in assessing pay-for-performance and the use of compensation consultants.

It is important for investors to have clear and complete disclosure of all the significant terms of compensation arrangements in order to reach informed opinions as to the performance of the compensation committee.

Finally, compensation committees are responsible for the oversight of internal controls in the executive compensation process. This includes controls over gathering information used to determine compensation, the establishment of equity award plans and the granting of equity awards. Lax controls can contribute to conflicting information being obtained, possibly through the use of nonobjective consultants, for example. Lax controls can also contribute to improper awards, such as those made through the granting of backdated or spring-loaded options, or through the granting of bonuses when the triggers for such payments have not been met.

We evaluate compensation committee members on the basis of their performance while serving on the compensation committee in question, and not for actions taken solely by prior members who are no longer serving on the committee.

When assessing the performance of compensation committees, we will recommend voting against the following members under the following circumstances:[25]

- All members of the compensation committee (from the relevant time period) if excessive employment agreements and/or severance agreements were entered into.
- All members of the compensation committee if performance goals were changed (i.e., lowered) when employees failed to meet – or were unlikely to meet – original goals, or performance-based compensation was paid despite goals not being attained.
- All members of the compensation committee if excessive employee perquisites and benefits were allowed.
- The compensation committee chair if the committee did not meet during the year, but should have (e.g., executive compensation was restructured).
- The compensation committee chair if the committee has fewer than three members.

NOMINATING COMMITTEE PERFORMANCE

The nominating committee, as an agent for shareholders, is responsible and accountable for the selection of objective and competent board members.

We will recommend voting against the following members of the nominating committee under the following circumstances:[26]

- All members of the nominating committee when the committee nominated or re-nominated an individual who had a significant conflict of interest, or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests.

25 If our recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will express our concern regarding the committee chair. In the absence of a compensation committee, we will recommend voting against the chairman of the board.

26 If the chairman of the committee is not disclosed, we will go against the most senior member on the committee. If the disclosure is so poor as to the composition of the committee(s), we will recommend voting against the chairman of the board. If the board does not have a nominating committee (or a committee that serves such a purpose), we recommend voting against the chairman of the board on this basis.

- The nominating committee chair if the nominating committee did not meet during the year, but should have (i.e., new directors were nominated).
- The nominating committee chair if the committee has fewer than three members.
- The nominating committee chair if the committee re-nominated a director who has not attended any board meetings.
- The nominating committee chair if: (i) less than one-third of the board is independent; (ii) there are more than 20 members on the board; (iii) there are less than five members on the board.

INVESTMENT TRUSTS AND INVESTMENT CORPORATIONS

BOARD STRUCTURE

Investment trusts and investment corporations are governed under the Japanese Investment Trust and Investment Corporation Act (the "Act"), and the Financial Instruments and Exchange Law. Pursuant to the Act, an investment trust/investment corporation is required to have a board of directors, which must be comprised of at least one executive director and at least two supervisory directors. The board must consist of one or more executive directors and the number of supervisory directors must be greater than, but not equal to, the number of executive directors. The boards of investment trusts and investment corporations typically consist of three directors: one executive director and two supervisory directors. Investment trusts and corporations are required to hold general meetings of shareholders once every two years.

ELECTION OF DIRECTORS

Executive directors on the boards of Japanese investment trusts and investment corporations are in charge of managing the company. Supervisory directors have the authority and responsibility to supervise the executive directors. In addition, the Act provides that a supervisory director must not be: (i) a founding member of the investment trust/investment corporation; (ii) an executive officer or employee of a founding organization of the investment trust/investment corporation or any of their subsidiaries; (iii) an executive director of the investment trust/investment corporation; (iv) an executive director or employee of the investment trust/investment corporation's affiliated security firms; and (v) a person who has a material, financial, familial or other relationship with the founding organization or the executive directors of the investment trust/investment corporation.[27] Thus, if we believe that a supervisory director does not meet the above requirements, or if we find any evidence that may call into question the director's independence, we will recommend shareholders vote against such a nominee. In addition, we will oppose supervisory directors during whose tenure accounting fraud occurred in the company or serious fraud was conducted by the executive directors.

The terms of office of both executive directors and supervisory directors of the investment trust/investment corporation are two years.

27 Article 164 of the Ordinance for Enforcement of Act on Securities Investment Trust and Securities Investment Corporations.

II. Transparency and Integrity in Financial Reporting

ACCOUNTS AND REPORTS/CONSOLIDATED ACCOUNTS AND REPORTS

In most countries, companies routinely submit annual financial statements and director and auditor reports for shareholder approval. In Japan, shareholders generally do not vote on financial statements, as most companies are required only to report the statements to the shareholders and shareholder approval is not necessary for them to be valid.

However, the Companies Act states that companies with less than ¥500 million in total assets are exempt from appointing an independent auditor or establishing a board of statutory auditors. If a company chooses not to appoint an independent auditor, the company is required to obtain shareholder approval of its financial statements at the annual meeting of shareholders. In such cases, financial statements are audited only by the statutory auditors.

We believe that the independent auditor's role as gatekeeper is crucial in ensuring the integrity and transparency of the financial information necessary for protecting shareholder value. The roles of statutory auditors and independent auditors are not the same and a proper and well-functioning auditing system exists only when the three main groups responsible for financial reporting – the board of directors, the statutory auditors and the outside independent auditors – form a "three-legged stool" that supports responsible financial disclosure and active participatory oversight. As such, we strongly believe that every listed company, regardless of its size, should appoint an independent auditor to ensure a fair and objective financial reporting process.

However, we believe that a disapproval of financial statements may not be in the best interests of shareholders. If the statements fail to obtain the necessary shareholder support, the company will be required to reexamine its statements to check for any inaccuracies and resubmit them at another general meeting of shareholders. Such a process could not only be costly for the company, but will also likely create a period of uncertainty, potentially harming investor confidence in the company.

Therefore, while we are hesitant to support any financial statements that have not been scrutinized by an independent auditor, we would generally support a proposal to approve such financial statements, provided that there has been no indication of inaccuracy.

In addition, if we are unable to obtain all the necessary documents (i.e., annual financial statements and statutory auditor reports), we will recommend shareholders abstain from voting on the proposal.

ALLOCATION OF PROFITS/DIVIDENDS

In Japan, the Companies Act grants companies with two-tier boards the right to allocate profits without shareholder approval if so stipulated in the company's articles, provided that the firm has implemented the following measures to improve its corporate governance: (a) the company has a board of statutory auditors (if it's a two-tier board); (b) the company has an independent auditor; and (c) the terms of directors on the is one year. If the company has granted the board authority to allocate dividends at its discretion, Glass Lewis will review the company's dividend policy and, where applicable, we may hold certain directors accountable for the company's dividend policy.[28]

A number of Japanese companies prefer to distribute stable dividends, rather than dividends that reflect performance or future capital needs. In our view, shareholders should expect more than a stable dividend from their investment. Investors typically purchase a company's common shares to share in the potential growth and upside in the business. When the company has a good year, shareholders should expect to see the excess profit

28 Companies that have adopted a unitary board structure have the authority to determine the allocation of profits by board resolution and without shareholder approval.

in their dividend checks, unless the company plans to utilize the capital to fund its growth and expansion, or if it needs the additional cash due to a capital shortage.

We generally support a company's policy when it comes to the payment of dividends (or the absence thereof). However, we will give particular scrutiny to cases where the company's dividend payout ratio, based on consolidated earnings, has decreased to an exceptionally low level (i.e. less than 10%) from a more reasonable payout ratio (i.e. over 10%), or where a company has eliminated dividend payments altogether without explanation. We will also scrutinize dividend payouts that are consistently excessively high relative to peers (i.e. over 100%) without satisfactory explanation. We will support uncovered dividends when we believe that such payouts are justified and will not negatively impact the financial health of the company in the long-term.

In most cases, we believe the board is in the best position to determine whether a company has sufficient resources to distribute a dividend or if shareholders would be better served by forgoing a dividend to conserve resources for future opportunities or needs.

APPOINTMENT OF AUDITOR AND AUTHORITY TO SET FEES

The auditor's role as gatekeeper is crucial to ensure the integrity and transparency of the financial information necessary for protecting shareholder value. Shareholders rely on the auditor to ask tough questions and thoroughly analyze a company's books to ensure that the information provided to shareholders is complete, accurate and fair, and that it is a reasonable representation of a company's financial position. The only way shareholders can make rational investment decisions is if the market is equipped with accurate information about a company's fiscal health.

Shareholders should demand an objective, competent and diligent auditor who performs at or above professional standards at every company. Similar to directors, auditors should be free from conflicts of interest and avoid situations requiring a choice between the auditor's interests and those of the public. Almost without exception, shareholders should be able to annually review an auditor's performance and ratify a board's auditor selection.

If we have concerns regarding the independence of an auditor and the appointment of the auditor is not presented for shareholder approval, we will raise our concern in the elections of statutory auditors or audit committee members.

In addition, under the 2004 Revised Certified Public Accountants Law, accountants are prohibited from auditing the same company for more than seven consecutive years, commencing from the year of enforcement. Under this law, only the accountants, not the firm, are prohibited from continuing to audit a company for more than seven years.

We note that Japanese companies rarely disclose the amount paid in non-audit fees in a timely manner. Most often, only the aggregate amount paid to auditors are disclosed in the business reports.

Voting Recommendations on Auditor Ratification

We generally support management's choice of auditor, unless we believe the auditor's independence or audit integrity has been compromised. If there have been material restatements of annual financial statements or a material weakness in internal controls, we usually recommend voting against the auditor. If the audited financial statements have not yet been disclosed, we base our voting recommendations on the company's financial statements for the previous year. We do not hold a company's auditor responsible for what may be the company's failure to comply with reporting obligations or a lack thereof, depending on the jurisdiction.

Reasons why we may not recommend in favor of the ratification of an auditor include:

- When the sum of audit fees and audit-related fees total less than 50% of overall fees paid to the auditor.[29]
- When there have been any recent restatements or late filings by the company and the auditor bears

29 If the company does not disclose a breakdown of audit and non-audit fees, we generally support the board of director's recommendation, except in cases where we believe the independence of the returning auditor or the integrity of the audit has been compromised.

some responsibility for the restatement or late filing (e.g., a restatement for due to a reporting error).[30]

- When the company has aggressive accounting policies.
- When the company has poor disclosure or a lack of transparency in financial statements.
- When there are other relationships or issues of concern with the auditor that might suggest a conflict between the interests of the auditor and those of shareholders.
- When the company is changing auditors as a result of a disagreement between the company and the auditor on a matter of accounting principles or practices, financial statement disclosures or auditing scope and procedures.
- When the company does not disclose sufficient information regarding the appointment or ratification of the auditor (e.g., the name of the auditor), we will recommend shareholders abstain from voting on the measure.

30 An auditor does not perform an audit of interim financial statements and, accordingly, we generally do not believe should be opposed for a restatement of interim financial statements, unless the nature of the misstatement is clear from a reading of the incorrect financial statements.

III. The Link Between Compensation and Performance

DIRECTOR AND STATUTORY AUDITOR COMPENSATION

Glass Lewis believes that non-employee directors and statutory auditors should receive reasonable amounts and types of compensation for the time and effort they spend serving on the board and its committees. In particular, we support compensation plans that include non performance-based option grants or other equity awards, which help to align the interests of board members with those of shareholders. Director and statutory auditor fees should be reasonable in order to retain and attract qualified individuals. However, excessive fees represent a financial cost to the company and threaten to compromise the objectivity and independence of non-employee directors and external statutory auditors.

BONUSES FOR DIRECTORS AND STATUTORY AUDITORS

Japanese companies may pay bonuses to their directors and statutory auditors. We believe that it is appropriate to make bonus payments to executive directors when there is a track record of strong performance and the proposed bonus is reasonable, taking into consideration the company's size and performance.

In general, we will recommend voting against bonus payments and other performance-based short-term incentives for outside directors and all statutory auditors since we believe performance compensation may align the interests of outsiders and statutory auditors with those of management, rather than shareholders. Outside directors and statutory auditors have the duty and responsibility to monitor the conduct of management for the protection of shareholder interests and maximization of shareholder returns. Performance-based bonuses and short-term incentives could be strong disincentives for outsiders and statutory auditors to exercise careful oversight of performance of management. Moreover, such types of compensation could threaten to compromise the integrity of a company's financial statements, as statutory auditors may be forced to weigh their own interests in relation to those of shareholders when overseeing the company's financial reporting. In short, we believe that these types of grants could create a situation wherein outside directors and statutory auditors are no longer independently representing the best interests of shareholders.

While we note that the payment of bonuses to outsiders is still a common practice in Japan and that the actual amounts of such payments generally make up a small percentage of an outsider's total compensation package, an increasing number of companies are voluntarily refraining from granting bonuses to outside directors and statutory auditors. As more companies appoint outside directors and the role of outsiders and statutory auditors becomes more critical, we believe that a better framework should be laid out for those in the position to satisfy oversight and supervisory roles. We therefore recommend that shareholders vote against proposals that award bonuses to outside directors and/or statutory auditors regardless of the size of the payment.

Additionally, we may recommend shareholders vote against a proposal to grant bonuses to inside directors if: (i) we believe that the company's performance does not justify the payment; or (ii) if the bonus is set to be paid to a director and/or a statutory auditor who had acted contrary to the interests of shareholders within the previous 12 months.

RETIREMENT BONUSES FOR DIRECTORS AND STATUTORY AUDITORS

A majority of companies have already eliminated the retirement bonus system, which is based on seniority rather than an individual's contribution or the performance of a company. However, given the traditional practice of such payments, these proposals continue to be put forward for shareholder vote. Retirement bonuses make up a large portion of compensation for directors and statutory auditors in Japan and the amount of compensation is usually left to the discretion of the board of directors or board of statutory auditors.

In our opinion, executive compensation should be linked to personal contributions or company performance, not merely length of service. We therefore strongly encourage the abolition of seniority-based retirement allowance systems and the adoption of performance-based compensation. We note that both domestic and overseas investors view retirement allowances with great skepticism and vote against these proposals routinely. Additionally, given that most companies have already abolished retirement bonus system, we no longer support retirement grants and/or any related proposals.

EQUITY-BASED COMPENSATION PLANS

Glass Lewis believes that equity compensation awards are a useful tool, when not abused, for retaining and incentivizing employees to engage in conduct that will improve the performance of the company. We generally evaluate option plans by taking into account the overall cost of the plan, the potential dilution to current shareholders, the size of the company and its performance.

We recognize that equity-based compensation programs have important differences from cash-based plans and bonus programs. Accordingly, our model and analyses take into account factors such as the administration of the plan, the method and terms of exercise, re-pricing history and express or implied rights to re-price and the presence of evergreen provisions, among other factors.

Our analysis is decidedly quantitative and focused on the cost of the plan as compared to the operating metrics of the business. In general, our model seeks to determine whether the proposed plan is either absolutely excessive or more than one standard deviation away from the average plan for the peer group on a range of criteria, including dilution to shareholders and the projected annual cost relative to the company's financial performance. Each of the analyses is weighted and the plan is scored in accordance with that weight.

Nonetheless, we believe that stock options should be granted as a form of compensation to people who directly contribute to the company's operation and/or performance, and that such awards should serve to encourage the grantees to protect and improve shareholder value. As such, we do not believe it is appropriate to extend awards to persons other than executive directors and employees. We generally oppose the granting of stock options to a broad range of participants, such as customers, suppliers, sub-contractors, consultants or other persons not in a position to positively contribute to company performance. We believe the board can abuse its authority and serve its own interests by, for example, granting options to a customer of the company who has an affiliation with the board or management. Therefore, considering the wide range of participants and the possibilities of improper use of the stock option grants by the board, Glass Lewis may recommend shareholders vote against an equity-based compensation plan if it allows for grants to non-employees.

In cases of limited disclosure by companies, Glass Lewis evaluates equity-based compensation plans by using a modified version of our multi-part model. In general, our model seeks to determine whether the value delivered to employees – as a percentage of market capitalization – and the potential dilution to shareholders are within a reasonable range.

In general, we evaluate option plans based on ten overarching principles:

- Companies should seek more shares only when they need them.
- Plans should be small enough that companies need approval every three-to-four years (or less) from shareholders.
- The annual net share count and voting power dilution should be limited.
- The annual cost of the plan should be reasonable as a percentage of financial results and in line with the peer group, especially if this cost is not shown on the income statement.
- The expected annual cost of the plan should be proportional to the value of the business.
- The intrinsic value received by option grantees in the past should be reasonable compared with the financial results of the business.
- The plan should deliver value on a per-employee basis when compared with programs at peer companies.

- Plans should not permit re-pricing of stock options.
- Plans should not contain excessively liberal administrative or payment terms.

DEEP DISCOUNTED STOCK OPTIONS

Deep discounted options plans provide the exercise of options at ¥1. Such options can be granted to directors, statutory auditors and/or employees. It is widely viewed that these option plans are generally adopted to replace seniority-based retirement allowance systems, since the option plans often incorporate a provision specifying that these deep discounted options may only be exercised upon retirement.

In case a proposed option plan contains a deep discounted exercise price of ¥1 and allows outside director and/or statutory auditor as eligible participants, we recommend that shareholders vote against the option plan. We believe that options should be granted as a form of compensation to people who directly contribute to the company's operations and/or performance and should serve to encourage the grantees to protect and improve shareholder value. As such, we believe it is appropriate for inside directors, executives and employees to be the sole recipients of these awards. In addition, Glass Lewis firmly believes that the exercise price of options granted as long-term incentives should be equal or close to the fair market value of the underlying stock on the date of grant. We do not believe that the exercise price of ¥1 per share will promote value of shareholders in the mid-or long-term.

DIRECTORS AND STATUTORY AUDITORS' FEES

Japanese companies are required to seek shareholder approval when changing the aggregate amount of fees that are payable to directors or statutory auditors. However, details regarding the compensation package of a director or the remuneration policy of an executive are generally not disclosed; only the aggregate amount of the compensation paid to directors and statutory auditors is disclosed.

We will generally support a proposal to change the aggregate amount of fees payable to directors and/or statutory auditors, so long as the proposed fees are not excessive, in particular relative to the company's peers. Companies may propose incorporating stock option schemes or other equity-based compensation plans into directors and/or statutory auditors' fees. In such circumstances, we generally evaluate the overall cost of the plan and potential dilution to shareholders, and we will support the compensation plan if we find it to be reasonable.

In the last few years, an increasing number of companies have introduced performance-linked compensation plans, which we view positively. However, as performance metrics are not disclosed based on either single metrics or absolute performance hurdles, when a company amends the remuneration level in conjunction with the introduction of pay for performance, we will examine the proposed policy closely. Additionally, Glass Lewis believes that outside directors' and statutory auditors' remuneration should not be linked to performance; if the two are linked together, we will recommend shareholders vote against such proposals. We also believe that shareholders are entitled to review how participants' performance is measured and linked to compensation in detail. If the disclosure is vague and a link to performance is unclear, we may recommend that shareholders voice their concerns by voting against such proposals.

EXECUTIVE COMPENSATION

As a general rule, Glass Lewis believes that shareholders should not be involved in setting executive compensation. Such matters should be left to the board or its compensation committee. We view the election of directors – specifically, the election of those who sit on the compensation committee or a committee that serves a similar function – as the appropriate mechanism for shareholders to express their disapproval or support of board policies on this issue. Further, we believe that companies whose compensation practices are in line with performance and the compensation of their peers should be granted the flexibility to compensate their executives in a manner that drives growth and profit.

However, Glass Lewis favors performance-based compensation as an effective means of motivating executives to act in the best interests of shareholders. Performance-based compensation may be limited if a chief executive's pay is capped at a low level rather than flexibly tied to the performance of the company.

IV. Financial Structure of the Shareholder Franchise

ANTI-TAKEOVER MEASURES

BACKGROUND ON ANTI-TAKEOVER DEFENSE PLANS

Takeover defenses were virtually non-existent in Japan as recently as 2004; however, by the end of June 2007, nearly 10% of all listed companies in Japan had adopted a takeover defense plan. While most companies continue to renew their takeover defense plans, the number of companies that have abolished them has outnumbered those that adopted them in recent years. Generally, there are three different types of poison pills in Japan: (i) the advanced warning type; (ii) the trust type; and (iii) the EGM type. While this categorization is useful in identifying the way in which a defense plan may be adopted or activated, the basic functionality of all three types of takeover defense plans is essentially the same.

ADVANCED WARNING DEFENSE PLAN

The vast majority of Japanese companies that have adopted takeover defense measures have adopted the advanced warning type of plan. This plan sets out general rules and policies for potential hostile takeovers in advance of a hostile offer, or in the complete absence of such an offer. If an acquirer does not meet the rules established by the target company, the target company may implement certain measures, such as the free allotment of stock acquisition rights and/or a stock-split, to prevent the takeover. The benefit of this type of plan is that it poses a very small financial cost to the company and is generally transparent, as it outlines the rules and processes of the defense measure. The board, or sometimes an independent third party, generally has the final authority on whether or not to activate the defensive measure.

The advanced warning plan can be adopted by the board without shareholder approval. However most companies voluntarily present the adoption or renewal of this type of takeover defense plan to shareholders for their approval, usually as an ordinary resolution that requires simple majority support to pass.

EGM DEFENSE PLAN

The so-called EGM defense plan is a variation of the advanced warning type. As with the advanced warning type, the EGM type sets out general rules and policies for a potential hostile takeover in advance, and in the absence of, a hostile offer. If a hostile offer is launched, the board would then require the bidder to comply with certain rules. If the bidder does not meet the requirements, the board may take measures to dilute the interests of the acquirer.

The EGM type is unique in that if the bidder meets the specified rules, the board would call an extraordinary meeting of shareholders (or a similar meeting that is not a shareholders' general meeting) to determine whether or not to activate the defense measure. Usually, shareholders can vote for or against the activation of the takeover measure at such a meeting. If shareholders reject the activation of the measure, then the offer can proceed. However, the board generally reserves the right to activate the defense measure without holding a shareholder's meeting if it deems the offer to not be in the best interests of the company and its shareholders.

This type of takeover defense is usually adopted without shareholder approval, as most companies that adopt this type of measure believe that it is sufficient to seek shareholders' opinion at the time of the hostile bid.

TRUST DEFENSE PLAN

The trust type defense plan involves the issuance of non-transferable stock acquisition rights – usually free of charge – to a trust bank. When a hostile offer is made, these rights may be distributed to all shareholders except for the acquirer. The shareholders can then exercise these rights (usually at ¥1 per share) to dilute the interest of the acquirer.

The trust type rights plan represents certain financial costs to the company upon adoption, and the adoption of this type of defense measure requires a two-thirds supermajority vote of shareholders. Due to these restrictions, this type of plan is rare in Japan. The decision regarding the activation of the stock acquisition rights is generally reserved for the board, although the board may be required to obtain advice from an independent third party.

GLASS LEWIS' APPROACH ON TAKEOVER DEFENSE PLANS

Glass Lewis believes that takeover defenses generally are not conducive to good corporate governance. Specifically, they can substantially limit opportunities for corporate takeovers and reduce management accountability. Studies have found that companies with greater protection from takeovers are associated with poorer operating performance that may lead to a decrease in firm value.[31] Other studies have shown that an increase in protection through anti-takeover statutes is associated with a decrease in management accountability.[32]

While a board should be given wide latitude in directing the activities of the company and charting its course, we believe that shareholders should have a direct say in a matter as important as a takeover defense measure. This issue is different from other matters that are typically left to the board's discretion because there is a greater likelihood of a divergence of views between managers and shareholders on this issue. Managers are often motivated to preserve their own jobs or arrange for substantial payouts and, as a result, their actions following a takeover bid may not always be in the best interests of shareholders. A recent study found that target CEOs are willing to accept lower acquisition premiums if they stand to earn personal, monetary or professional gains from the proposed deal.[33]

One of Japanese issuers' main justifications for adopting a takeover defense plan is that it ensures the board and shareholders will have sufficient information to make an informed judgment by requiring the bidder to disclose certain information. However, the newly promulgated Financial Instruments and Exchange Law grants companies that are the target of a takeover bid a right to demand information from the bidder. Pursuant to said law, the target company can request that the bidder answer any questions it deems relevant, and the bidder must send replies to the target company and the Financial Services Agency. The bidder can choose not to answer specific question; however, the bidder must provide a rationale for choosing to not answer the question.

The right to demand information provided by the Financial Instruments and Exchange Law provides the target board a tool to obtain information that it believes is necessary for shareholders to evaluate the offer, thereby reducing the necessity of a takeover defense. While this right is relatively limited compared to an authority granted under a typical takeover defense, as the target company is not entitled to request additional information or to demand further explanation on the bidder's answers, we believe that this right under the law is generally sufficient for shareholders to obtain information that they may need to make an informed judgment.

In certain circumstances, however, we will support the adoption of a poison pill or similar takeover defenses that are limited in scope, provide reasonable protection to shareholders and are designed to provide the board and shareholders with adequate time to pursue value-maximizing alternatives. These defense plans, when drafted properly, encourage a potential acquirer to negotiate with the board directly. In general, we believe that a reasonable takeover defense plan in Japan must satisfy all of the following requirements:

- Shareholder approval is required for adoption and renewal.
- The term of the takeover defense plan is no more than three years.
- The takeover defense plan can be abolished by a resolution submitted by shareholders.
- The trigger threshold of the plan is 20% or higher.
- For a company with a two-tier board structure, there must be at least two independent directors on the board, and for a company with a unitary board structure, at least one-third of the board should be independent.

31 Paul A. Gompers, Joy L. Ishii and Andrew Metrick. "Corporate Governance and Equity Prices." *NBER Working Paper No. 8449*. 2001; R. Bauer, B. Frijns, R. Otten and A. Tourani-Rad. "The Impact of Corporate Governance on Corporate Performance: Evidence from Japan." *GMI Governance and Performance Studies*, May 2005.

32 Marianne Bertrand and Sendhil Mullinathan. "Is there Discretion in Wage Setting? A Test Using Takeover Legislation." Rand Journal of Economics. 1999, page 535; Gerald T. Garvey and Gordon Hanka. "Capital Structure and Corporate Control: The Effect of Antitakeover Statutes on Firm Leverage." *Journal of Finance*. 1999, pages 519, 520.

33 Jay Hartzell, Eli Ofek, and David Yermack. "What's In It For Me?: Personal Benefits Obtained by CEOs Whose Firms Are Acquired." *Working Paper.* 2000, page 21.

- The administration of the defense plan is monitored by an independent third party.
- The information disclosure requirement, if any, is reasonable with respect to amount, timing and type of information required.
- The total consideration period, if any, of the information disclosed pursuant to the defense plan does not exceed 120 calendar days, given that the initial consideration period does not go over 90 calendar days.
- There is no unreasonable "exceptions clause."
- There is no clause that allows for the provision of monetary compensation to the bidder.
- There is no evidence of the board's abuse of a prior takeover defense plan, gross negligence, and egregious lack of oversight or disregard of shareholder value.

Where these requirements are met, we typically feel comfortable that shareholders will have the opportunity to voice their opinion on any legitimate offer.

ADOPTION, RENEWAL AND REVOCATION OF A TAKEOVER DEFENSE PLAN

We believe the adoption and renewal of a takeover defense plan should require shareholder approval at a general meeting of shareholders, and that the plan should clearly state that shareholders have the right to abolish it through a resolution. In some cases, a defense plan stipulates that shareholders can vote on such matters as adoption, renewal and/or revocation through the votes cast for the election of directors. We believe that regardless of the directors' terms and election process, the adoption and renewal of a defense plan should be a matter on which shareholders can vote directly. Further, shareholders should be granted the right to revoke the defense plan through a shareholder resolution. It is unclear as to how the votes cast in the election of directors would be reflected in the decisions concerning the defense plan.

One exception to this policy is when a takeover defense plan is adopted by board resolution but is presented to shareholders at a general meeting for ratification and approval. While we prefer that companies seek shareholder consent prior to the adoption of a takeover defense plan, we generally do not oppose the adoption of a takeover defense plan solely on this basis, as the adoption of most types of takeover defense plans does not require shareholder approval under Japanese laws and regulations. We support a board's decision to seek shareholder approval, even if it is after the fact, absent any evidence of abuse.

To this end, we would generally recommend voting against takeover defense plans if: (i) the term of the plan is longer than three years; (ii) the renewal of the plan does not require shareholder approval;[34] or (iii) the plan does not state that it can be abolished by shareholders through a resolution at a shareholders' meeting. If a takeover defense plan is adopted or renewed by the board without shareholder approval and is not, or has not been presented to shareholders for ratification,[35] we generally recommend shareholders vote against the re-election of the chairman of the board for his/her failure to seek shareholder consent for the adoption or renewal of a poison pill.[36]

TRIGGER THRESHOLD

We believe that the trigger threshold of a takeover defense plan should be not be lower than 20% of a company's outstanding ordinary shares. A lower threshold may limit investors' ownership in companies, potentially discouraging institutional investors from taking advantage of investment opportunities, especially in smaller companies. In our opinion, a 20% or higher trigger threshold is appropriate, as investors seeking such a large share in a company are more likely to be seeking control of the company.

Accordingly, we would recommend shareholders vote against any takeover defense plan with a trigger threshold of less than 20%. In limited circumstances, however, we may support takeover defense plans with a lower trigger threshold if they exempt institutional and/or passive investors.

34 If the plan fails to specify the manner in which it can be renewed, we will indicate this but will not recommend voting against the plan solely on this basis.

35 We apply a 12-month look-back period for the adoption and renewal of a takeover defense plan without shareholder approval.

36 In the absence of a chairman position, we would recommend shareholders vote against the president or CEO.

BOARD INDEPENDENCE

We believe that some level of board independence is imperative for ensuring the protection of minority shareholders' interests in the event of a hostile approach. A lack of sufficient board independence can raise significant concerns regarding the board's objectivity, independence and ability to protect all shareholders' interests in evaluating a takeover offer and whether to employ the takeover defense to prevent the takeover. Without sufficient independent board representation, we do not believe that shareholders should entrust the board to make decisions in the context of hostile takeover attempt.

INDEPENDENT THIRD PARTY OVERSIGHT

In order to minimize the risk of a takeover defense plan being used by management for their own interests rather than shareholders', we believe that a party free of any affiliation to the company that may result in a conflict of interest should oversee the administration of the takeover defense plan. The independent third party should, in our opinion, consist of a group of solely non-executive outsiders, such as outside directors and external statutory auditors, all of whom should be independent.[37] The company must demonstrate the independence of the third party through public disclosure.

If the independent third party is not entirely independent, or if the company does not disclose sufficient information to allow shareholders to evaluate the independence of the third party, we will recommend that shareholders vote against the takeover defense plan.

INFORMATION DISCLOSURE REQUIREMENT

In Japan, we typically see a provision requiring the acquirer to disclose to the target company: (i) the details of the acquirer; (ii) the purpose, method and terms of the acquisition; (iii) the basis for the calculation of the offer price; and (iv) a post-acquisition management policy. We generally believe that it is reasonable to require some level of disclosure of this type of information.

However, we understand that there is a limit to the amount of information the acquirer can disclose. Therefore, we believe that the acquirer should either be given the option to withhold information, or the information requested to the potential acquirer should not be excessive.[38] In addition, we believe that in the event of an all-cash offer with intent to acquire all outstanding shares, shareholders do not require such exhaustive information to make an informed judgment. We will, accordingly, view takeover defense plans more favorably if they exempt this type of offer from some of the information disclosure requirements.

We are generally concerned with provisions requiring the disclosure of what we believe is unnecessary, excessive or irrelevant information. Examples of such extraneous information include: (i) details of similar types of transactions sought by the acquirer; (ii) the probability of the success of the acquisition; (iii) the existence of communication with third parties, such as financial advisors, consultants and affiliated parties, and its contents; (iv) the planned treatment of and/or effects upon such stakeholders as local communities, business partners and clients; and (v) the measures for sustainable and continuous improvement of the company's corporate value and the grounds that prove such measures will be effective. Some of the requested disclosure items may be extremely difficult, if not impossible, to accurately assess. We therefore do not believe that the acquirer should be required to disclose such information. These additional disclosure requirements can be so arduous to fulfill that they potentially would serve to deter an acquirer from acquiring the company.

Accordingly, we generally recommend shareholders vote against takeover defense plans that require the disclosure of the types of inappropriate or excessive information discussed above.

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37 We generally prefer the independent third party to be composed of independent directors and/or independent statutory auditors, as they can be held accountable to shareholders through the election process.

38 In its report entitled "[The Proper Role of Takeover Defense Measures in Light of Changes in Various Environments]" issued on June 30, 2008, the Corporate Value Study Group, a special task force organized under the Ministry of Economy, Trade and Industry, states that demanding an exhaustive disclosure of underlying assumptions and facts used in calculating the offer price, or of detailed management plans, and then to activate a defensive measure on the basis of the absence of some of the requested information is unreasonable and inappropriate.

Further, we generally do not approve of provisions that authorize the board and/or an independent third party to request, after receiving the disclosed information from the acquirer, any additional information without limitation or a clear timeframe should they deem the previously disclosed information to be insufficient or inappropriate. While we understand that a request for additional disclosure may be needed in some limited circumstances, there should be a clear timeframe and a limit to how much and how many times such a disclosure can be requested. As the consideration of the offer will not commence until the board and/or independent committee has determined that all information has been submitted in a satisfactory manner, the offer could be suspended indefinitely. Such a provision could be used to thwart potentially beneficial offers and goes beyond what we believe is necessary and/or appropriate. We therefore do not support takeover defenses that contain a provision granting the right to request additional information without limitation.

CONSIDERATION PERIOD

The typical Japanese takeover defense plan provides the board and/or independent third party with 60-to-90 calendar days to consider the information disclosed by the acquirer pursuant to the information disclosure requirement. This period is also to allow for the board and/or independent party to review and consider the offer, form its opinion, negotiate the terms of offer or seek better alternatives. During this period of consideration, the bidder is generally prohibited from acquiring any additional shares in the company or from initiating a takeover bid. Should the bidder violate this rule, the board is generally authorized to activate a defensive measure to thwart the bid. Moreover, if the board and/or independent third party determines during the consideration period that the offer is "abusive" in accordance with the terms of an exceptions clause, as discussed below, the board may take the necessary steps to activate defensive measures.

We generally prefer short consideration periods. In our opinion, 90 days is sufficient time to consider an offer, formulate counter-offers or negotiate terms.[39] However, we will permit the board and/or administrator to extend the consideration period to up to 120 days, including the initial consideration period. A longer consideration period may discourage a potential acquirer, as the offer will be subject to a greater period of uncertainty.

We therefore generally oppose any takeover defense plan where the initial consideration period granted to the target company exceeds 90 calendar days, or when added together with extension period exceeds 120 days. We are also wary of provisions that allow the extension of the consideration period to any such length as deemed necessary by the board and/or independent third party.

EXCEPTIONS CLAUSE

Most takeover defense plans adopted by Japanese companies contain a provision we call an "exceptions clause." The exceptions clause generally allows for the activation of takeover defenses if the offer is deemed by the board and/or independent third party to pose an imminent threat to corporate and shareholder value, even when the offeror diligently follows the rules stipulated under the takeover defense plan. We will support takeover defense plans with an exceptions clause only when the conditions under such clause are limited and reasonable, and the evaluation of the offer to determine whether the offer presents an "imminent threat" will not be carried out by the board and/or a party dominated by insiders and affiliates.

Taking into consideration court rulings in Japan, we believe that a provision authorizing the activation of a defensive measure in the following types of offer situations provides reasonable protection to shareholders: (i) coercive two-tier tender offers; (ii) acquiring shares with the intent of requiring the company or its associates to repurchase them at an inflated price; (iii) temporarily taking control of the company's management to transfer the company's valuable assets at an unfair price for the benefit of the acquirer; (iv) pledging assets of the company as collateral for the debts of the acquirer or its group, or using the company's funds to repay such debts; and (v) temporarily taking control of the company's management and causing the company to dispose of valuable assets

39 Generally, takeover defense plans in Japan grant the board 60 calendar days to consider an all-cash offer and 90 days for any other type of offer. The board will determine, with reference to the independent third party's opinion, whether the offer would harm the corporate and shareholder values of the company. In some cases, the independent third party may grant the board as many as 60 calendar days to consider the offer and form its opinion. Upon the completion of the board's consideration period, the independent third party will have an additional 60 days to review the information disclosed by both the board and bidder. In practice, this grants the company a total of 120 calendar days to consider the offer and seek alternatives. As such, we almost always oppose this type of plan.

unrelated to its core business for the purpose of declaring high dividends, or to sell the company's shares at a higher price by taking advantage of the appreciation in stock price caused by the declaration of high dividends.[40]

We generally do not support any takeover defense plans that allow management to activate a defensive measure for any reasons other than those described above. The commonly used provisions that we find to be problems include, among others, measures that grant the board and/or independent third party the ability to activate a defensive measure if: (i) the company, board, independent third party and/or shareholders are not provided with sufficient time and information to consider the offer; (ii) the terms and conditions of the offer are inadequate or insufficient considering the company's intrinsic value; (iii) the offer is not in the best interest of the company, taking into account the interests of its shareholders, employees, business partners, clients, local community and other stakeholders; (iv) the acquisition threatens to materially harm the company's corporate value by destroying the company's corporate culture, brand image and/or its relationship with its shareholders, employees, partners and/or local communities; (v) the mid- to long-term corporate value of the company under the acquirer's control is considered materially subordinate to the case where the company is not under such control; and (vi) the acquirer is deemed inappropriate as a controlling shareholder of the company from the perspective of public order and morals. These vague provisions provide the board with too much discretion and could be used to thwart a potentially beneficial takeover offer. As such, we do not support the adoption of a takeover defense plan that contains any of the aforementioned provisions or similar measures.

PROVISION OF MONETARY COMPENSATION TO THE BIDDER

In 2007, when U.S.-based fund Steel Partners, which is widely regarded in Japan as an activist investor, proposed to buy Bull-Dog Sauce Co., the company adopted a takeover defense plan to ward off the hostile approach. Bull-Dog Sauce's poison pill included a provision that allowed the company to give the bidder cash compensation for the dilution it could have suffered as a result of the activation of the poison pill. The company's actions and its poison pill were contested in the courts and Bull-Dog Sauce won in both the Tokyo District Court and the Supreme Court. Bull-Dog Sauce activated its poison pill, diluting Steel Partners' stake, and paid the fund approximately ¥2.3 billion as a compensation for the dilution. Steel Partners is said to have made gains of approximately ¥5 billion as a result.

The Bull-Dog Sauce case prompted a number of Japanese corporations to adopt a takeover defense plan with provisions enabling the company to compensate the buyer, as such takeover defense plans are more likely to win the court's support. However, the provision of monetary compensation to the bidder has been harshly criticized by institutional investors as encouraging green-mailers rather than discouraging them, and as promoting the activation of a defensive measure rather than promoting a dialogue between the relevant parties. Such compensation can therefore result in the outflow of company capital that could have otherwise been returned to all shareholders or invested to increase shareholder value.

We strongly oppose takeover defense plans that allow for the granting of monetary compensation to the acquirer. We believe that a takeover defense should not be activated under almost all circumstances, and that such a plan should be designed to maximize shareholder value by encouraging negotiation and providing sufficient time to seek value maximizing alternatives. Given the legal precedents, we understand that the inclusion of monetary compensation in a defense plan is likely to help it win the support of the courts in Japan; however, if a board truly believes that the offer will harm shareholder value, then the company should defend its position rather than using shareholders' money to pay off the acquirer. Accordingly, we will recommend shareholders vote against all takeover defense plans that contain this provision.

40 The Corporate Value Study Group believes that the board of a target company should not assert that the activation of a takeover defense is necessarily based on the fact the acquirer likely will pledge the target company's assets or distribute high dividends, as such actions do not necessarily harm shareholder value. While we agree with the study group that these actions do not always cause substantial harm to shareholder value, given the opinion of the Tokyo District Court in the Nippon Broadcasting case, March 23, 2005, in which the court defined buyers with intent to carry out any of the actions discussed above as potentially abusive, we accept the presence of these provisions.

EVIDENCE OF ABUSE

We believe that a board's commitment to shareholder value is demonstrated through the actions taken by the board and its members. We therefore look closely at a board's past actions, and where we find a record of poor performance, gross negligence, egregious lack of oversight or disregard of shareholder value, we will recommend shareholders vote against the proposed takeover defense plan regardless of its mechanism. In our opinion, shareholders should not give the benefit of the doubt to a board that has proven to be unable or unwilling to protect shareholders' interest.

EXCESSIVE CROSS-SHAREHOLDING

Mutual equity ownership among business partners, creditors and listed companies separates economic interest from voting rights and shields management from the disciplining pressure of the capital market. Such practices have been attributed to decreased management accountability, lax risk management and inefficient capital management policy, and have been shown to limit potential hostile approach. Though companies often attempt to justify these cross-shareholding relationships as strategically important, the benefits of such relationships, if any, are generally both unquantifiable and unclear. While some level of management stability, access to capital, favorable business relationships and general synergistic value may be derived from mutual equity ownership, and while it is possible that this may ultimately add to long-term shareholder value, academic research supports the contrary. Empirical research has found a correlative relationship between a decrease in cross-shareholding relationships and a converse increase in corporate performance, suggesting that cross-shareholding relationships are more likely to suppress the shareholder value than enhance it.

The practice of investing in the securities of banks, insurers and other public companies not only exposes shareholders to undisclosed risks, but also enables management to utilize shareholders' capital for its own self-preservation. Under Japanese accounting rules, if the market value of securities in which a company has invested falls below 50% of the purchase price, the company is required to record the loss on its balance sheet. Often the returns on these investments are disproportionate to the risks, as evidenced by a number of companies which have recorded or are expected to record losses related to their recent securities investments due to market volatility. Additionally, under Japanese regulations, cross-shareholding relationships can be established at the sole discretion of the board without shareholder approval and with little or no reporting requirement depending on the size of the equity stake. Thus, using shareholder capital, the management effectively creates unsanctioned friendly partnerships from which the board benefits while shareholders may not.

While such practices are commonplace in Japan, given the aforementioned concerns regarding both general security investment practices and cross-shareholding relationships in Japan, we recommend voting against the chairman of the board if the company has material strategic investments in other companies, excessive cross-shareholdings and takeover defense plan. We believe that the most crucial test of a board's commitment to the company and its shareholders lies in the actions of the board and its members. In our opinion, extensive cross-shareholdings and placement of takeover defense plan indicate the management entrenchment at the Company, the board's disregard for the shareholder value and its willingness to protect itself at shareholders' cost.

AMENDMENTS TO THE ARTICLES OF ASSOCIATION

We will evaluate proposed amendments to a company's articles of incorporation on a case-by-case basis. We are opposed to the practice of bundling several amendments under a single proposal because it prevents shareholders from judging each amendment on its own merits and is a practice which we believe negatively limits shareholder rights. In such cases, we will analyze each change individually. We will recommend voting for the proposal only when, on balance, we believe that all of the amendments are in the best interests of shareholders.

SUPERMAJORITY VOTE REQUIREMENTS

Glass Lewis believes that supermajority vote requirements act as impediments to shareholder action on ballot items that are critical to shareholder interests. One key example of such a problem is in the takeover context, as supermajority vote requirements can strongly limit the voice of shareholders in making decisions on such crucial matters as selling the business.

REDUCTION OF QUORUM REQUIREMENT

Glass Lewis will generally recommend voting against this proposal due to the large concentration of share ownership in Japan. Companies may seek to lower the voting quorum requirement for special business proposals from 50% of issued shares to one-third. However, in many companies, enough shares are held by a parent company or a founding family to meet the one-third quorum requirement. Such a proposal could have the effect of disenfranchising independent shareholders.

INCREASE IN AUTHORIZED SHARES

Glass Lewis believes that adequate capital stock is important to a company's operation. When analyzing a request for additional shares, we typically review four common reasons why a company might need additional capital stock:

Stock Split – We typically consider three metrics when evaluating whether we think a stock split is likely or necessary: (i) the historical stock pre-split price, if any; (ii) the current price relative to the company's most common trading price over the past 52 weeks; and (iii) some absolute limits on stock price that, in our view, either always make a stock split appropriate if desired by management, or would almost never be a reasonable price at which to split a stock.

Shareholder Defenses – Additional authorized shares could be used to bolster takeover defenses such as a "poison pill." Proxy filings seeking additional shares often discuss the usefulness of such shares in defending against or discouraging a hostile takeover. Glass Lewis typically opposes such defenses, and we will oppose actions intended to bolster such defenses. We may, however, support such an increase in authorized shares if we find that the company's takeover defense is reasonable.

Financing for Acquisitions – We look at whether the company has a history of using stock for acquisitions and attempt to determine what levels of stock have typically been required to accomplish such transactions. Similarly, we look to see whether this is discussed as a reason for additional shares in the proxy.

Financing for Operations – We review the company's cash position and its ability to secure financing through borrowing or other means. We look at the company's history of capitalization and whether the company has had to use stock in the recent past as a means of raising capital.

Issuing additional shares can dilute existing holders in limited circumstances. Further, the availability of additional shares, where the board has discretion to implement a poison pill, can often serve as a deterrent to interested suitors. Accordingly, where we find that a company has not detailed its plan for using the proposed shares, or where the number of shares far exceeds those needed to accomplish a disclosed plan, we typically recommend shareholders vote against the authorization of additional shares.[41]

While we think that having adequate shares to allow management to make quick decisions and effectively operate the business is critical, we prefer that, for significant transactions, management asks shareholders to approve the use of additional shares, rather than asking shareholders to provide a blank check in the form of a large pool of unallocated shares available for any purpose.

ISSUANCE OF SHARES AND/OR CONVERTIBLE SECURITIES

Pursuant to the TSE Listing Rules, issuers must provide greater details regarding certain issuances involving private placement of shares and convertible securities. For placements that may result in dilution of more than 25%, issuers must either obtain prior shareholder approval or an independent third party's opinion. While the rules are intended to curb private placements that detrimental to existing shareholders, shareholders generally do not have much say in the issuance of securities and issuers rarely seek shareholder approval at general meetings.

41 We typically oppose any increase in authorized shares if the proposed increase will result in authorized shares exceeding 300% of the issued and outstanding shares.

While we think that having adequate shares to allow management to make quick decisions and effectively operate the business is critical, we prefer that, for significant transactions, management seek shareholder approval of the use of additional shares, rather than being provided with a large pool of unallocated shares available for any purpose. We will review any issuances of shares or other securities on a case-by-case basis, and if we find the proposed issuance unwarranted or its terms and conditions unreasonable, we may recommend shareholders vote against the proposed issuance.

AUTHORITY TO TRADE IN COMPANY STOCK

A company may want to repurchase or trade in its own shares for a variety of reasons. A repurchase plan is often used to increase the company's stock price, distribute excess cash to shareholders or provide shares for employees' equity-based compensation plans. In addition, a company might repurchase shares in order to offset a dilution of earnings caused by the exercise of stock options.

We will recommend voting in favor of a proposal to repurchase and trade in company stock when the following conditions are met: (i) the company sets a maximum number of shares that may be purchased; (ii) a maximum price that may be paid for each share – as a percentage of the market price – is determined; and (iii) the authority expires in 18 months. Furthermore, the Companies Act limits the number of shares that may be repurchased to no more than 10% of the company's capital (or 5%, if the stock will be used as consideration in a merger transaction).

WAIVER OF SHAREHOLDER APPROVAL FOR SHARE REPURCHASE

The Companies Act allows companies, when stipulated in their articles of incorporation, to repurchase shares without prior approval from shareholders, essentially setting the upper limit on such repurchases at the same level as the cap for funds available for the payment of interim dividends. Glass Lewis does not believe that it is in the best interests of shareholders to grant full discretion over repurchases to the board.

SALE OF BROKEN LOTS OF SHARES

A shareholder holding less than one voting unit of shares may request that the company sell the shareholder the number of shares needed to hold a full voting unit of shares, together with the current shares owned by the shareholder. We support this proposal, as it improves the liquidity and marketability of a company's stock.

AUTHORITY TO REDUCE CAPITAL OR EARNED RESERVE

Japanese companies are allowed to transfer any portion of the capital reserve and earned reserve that exceeds 25% of paid-in capital to its capital surplus and earned surplus, respectively, in order to implement more flexible capital policies.

We typically recommend voting for this proposal because we believe it is in the best interests of shareholders for the company to have the flexibility to use these funds for other purposes, including dividend payouts.

LIMIT LIABILITY OF DIRECTORS AND STATUTORY AUDITORS

There is no explicit provision that prohibits the company from indemnifying directors with respect to liability incurred against a third party that is incurred in their capacity as directors. If the articles of incorporation of a company contain a specific provision, the board can discharge a certain portion of the directors' or statutory auditors' liability to the company itself. The liable amount is calculated based upon a formula specified in the Companies Act. Under the Companies Act, corporations can enter into a contract with their directors and statutory auditors limiting their liability to the company to a certain amount.

The law allows for liability ceilings of up to six years' worth of compensation for directors with representative rights, four years' worth of compensation for other inside directors and two years' worth of pay for outside directors and statutory auditors. The board of directors would have the right to impose these limits after a derivative suit is filed, but, as provided by the law, the limitations would not apply to cases of gross negligence or criminal behavior, and they would further only apply if the individual acted in good faith. If shareholders representing more than 3% of issued capital vote to nullify the limits, the board's decision would have no impact.

Glass Lewis believes that directors and statutory auditors should be held responsible when they fail to fulfill their duties to shareholders. However, we understand that providing for a certain level of protection is reasonable to attract and retain qualified board members. We believe that in most cases, directors and statutory auditors may be indemnified to a greater extent, but they will still be held liable for fraudulent or grossly negligent actions. Thus, generally, Glass Lewis will not recommend voting against a proposal to limit directors or statutory auditors' liability.

V. Shareholder Initiatives and Sustainable Business Practices

We evaluate all shareholder proposals on a case-by-case basis. We generally favor proposals that are likely to increase shareholder value and/or promote and protect shareholder rights. We typically prefer to leave decisions regarding day-to-day management of the business and policy decisions such as those related to strategy, political, social or environmental issues to management and the board except when there is a clear and direct link between the proposal and an economic or financial risk for the company. We feel strongly that shareholders should not attempt to micromanage the business or its executives through the initiative process. Rather, shareholders should use their influence to push for governance structures that protect shareholders, including through director elections, and promote the composition of a board they can trust to make informed and careful decisions that are in the best interests of the business and its owners. We believe that shareholders should hold directors accountable for management and policy decisions through the election of directors.

When reviewing and making voting recommendations for shareholder proposals, we examine the circumstances at each company on a case-by-case basis. We thoroughly research each firm, using publicly available information, such as annual reports, sustainability reports, companies' websites, NGO websites, and news sources. When we identify situations where shareholder value may be at risk, we will note our concerns in the relevant section of the Proxy Paper analysis and also in any applicable shareholder proposals. We will also recommend voting in favor of a reasonable and well-crafted shareholder proposal if we believe supporting the proposal will promote disclosure of or mitigate significant risk exposure.

For a more detailed discussion of our approach to shareholder proposals and initiatives, please see Glass Lewis' *Shareholder Initiatives Policy Guidelines*.

DISCLAIMER

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