



IRRC Governance Research Service 2003 Background Report C:

CLASSIFIED BOARDS

**Christopher Shier
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SUMMARY

Classified boards are those with staggered terms. Typically, one-third of the board is elected in any given year. Critics view board classifications as an entrenchment device that, among other things, makes winning a battle for board control more difficult to achieve. Critics also say that electing directors on an annual basis increases their accountability to shareholders. Companies generally defend staggered elections as a way to ensure continuity and stability on the board and as a protection against any unsolicited change in board membership.

Shareholder proposals to repeal classified boards continue to win high levels of voting support. In 2002, shareholder proposals requesting the repeal of classified boards ranked among the highest in terms of the number of shareholder proposals relating to any single corporate governance issue, and received the highest average level of voting support. The 42 shareholder proposals that came to a vote in 2002—slightly less than the 46 proposals voted on in 2001—received average support of 61.6 percent of the votes cast.

Despite shareholder support for the elimination of classified boards, management proposals to adopt classified boards continue to outpace management proposals to eliminate a staggered board structure. Additionally, during 2002, all management proposals to adopt a classified board structure, for which voting results are available, passed. Interestingly, companies are finding it more difficult to get the support necessary to repeal classified board structures; three of the seven management proposals to repeal classified boards in 2003 did not pass.

Trends

- Shareholder proponents submitted 51 proposals to declassify boards at 2002 annual meetings, with 42 of the proposals actually coming to a vote. In 2001, IRRC tracked 55 proposals, with 46 that came to a vote.
- Support for shareholder proposals to repeal classified boards in 2002 continued to reach high levels of support with an average vote of 61.6 percent of the votes cast. This represents an increase in support for such proposals from the two previous years, when support was around 53 percent.
- Shareholder proposals at 37 companies scored majority votes, up from 32 companies in 2001. A record 36 proposals passed under company voting requirements in 2002. The approved proposals were precatory, simply asking the company to consider the request.
- In 2002, 11 companies sought to adopt classified boards. In recent years this number peaked in 1998, at 21 such proposals, with an additional 20 proposals to adopt a classified board structure in 2001. However, the number of management proposals to implement classified boards has significantly declined in the past 15 years, from a high of 88 proposals in 1986.
- Seven companies proposed to eliminate their staggered election system in exchange for the annual election of all directors in 2002. Similarly, seven companies proposed the repeal of their classified boards in both 2001 and 2000.
- One company, KeyCorp, sought approval to eliminate its classified board after a shareholder proposal received majority support in both 2001 and 2000. Interestingly, the management proposal, which required support from 75 percent of the outstanding shares to pass, garnered support from only about 40 percent of the outstanding shares. Institutional holdings at that time accounted for more than 50 percent of the company's outstanding stock.
- Shareholder proposals to declassify boards will remain high in number 2003. IRRC has tracked 46 similar proposals for the upcoming year, which is slightly ahead of proposals tracked this time in 2002. Evelyn Y. Davis has submitted a third of these proposals for 2003.
- Of the approximately 2,000 companies in IRRC's core research universe, approximately 60 percent have classified boards. This number has not changed significantly in recent years.

About this report

This report relies mostly on data from about 2,000 companies that are in the IRRC core research universe, which includes the S&P Super 1,500 companies. IRRC also tracks management proposal information for 2,000 additional companies. Unless otherwise indicated, information on shareholder proposals is based solely on companies in the core research universe, while management issues relate to the larger 4,000 company IRRC universe.

I. BACKGROUND AND ECONOMIC IMPACT OF CLASSIFIED BOARDS

Shareholder opposition to classified boards has strengthened year by year, as measured by votes on shareholder resolutions; support for such resolutions has risen from an average of 17.5 percent in 1986, to 61.6 percent in 2002.

In addition, the number of companies proposing to adopt classified boards has slowed down considerably since the 1980's, when adopting a classified board became popular to protect against unsolicited takeovers (see Figure 1). However, in 2002, 10 of the 11 management proposals to adopt classified boards passed. Additionally, the number of companies adopting (or attempting to adopt) classified boards continues to outpace those attempting to eliminate the structure.

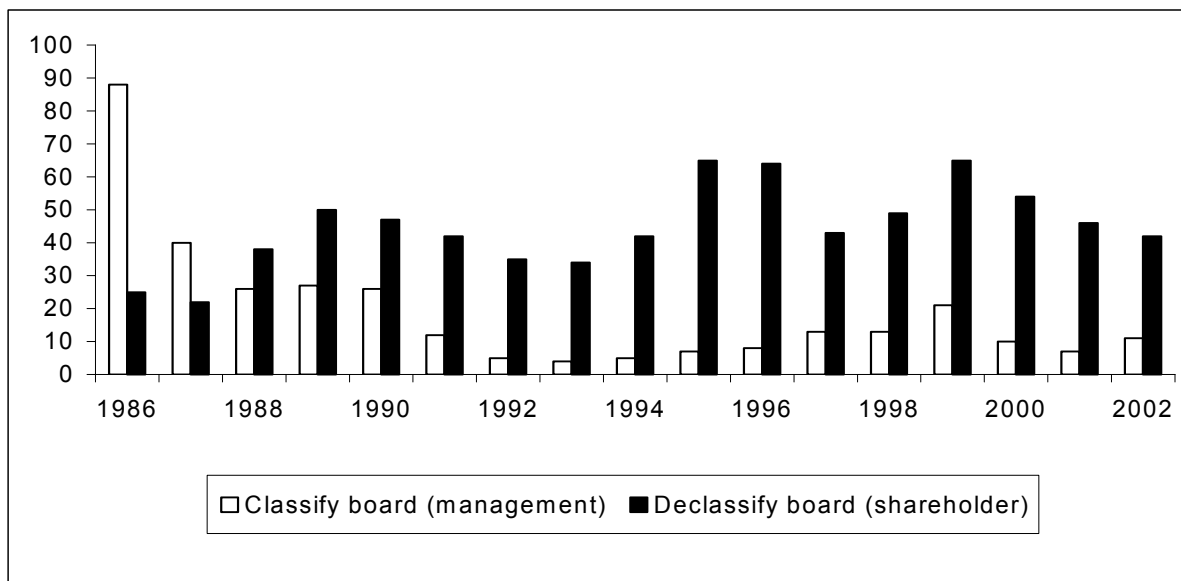


Figure 1: Shareholder proposals to declassify boards v. management proposals to classify boards, 1986-2002

The proportion of large companies with classified boards has remained fairly constant in recent years. The number of companies with classified boards increased slowly in the early 1990s, and has leveled off since 1994, when 59 percent of the companies in IRRC’s research universe had classified boards. Of the nearly 2,000 companies in IRRC’s current research universe, around 60 percent have classified boards. That percentage increases slightly as the universe is narrowed to just the S&P 1,500 companies, as shown in Table 1. Table 2 illustrates that companies at the highest and the lowest ends of the revenue spectrum are least likely to have classified boards.

Table 1: S&P 1,500 companies with classified boards by index, 2002*

S&P 500	S&P MidCap	S&P SmallCap	S&P 1,500
62%	65%	61%	63%

*Taken from IRRC’s study *Board Practices/Board Pay 2002*.

Table 2: S&P 1,500 companies with classified boards by revenue, 2002*

Revenue group (# of companies)	% with classified board
\$25 billion + (26)	44
\$10 < \$25 billion (57)	62
\$5 < \$10 billion (84)	68
\$3 < \$5 billion (77)	68
\$1 < \$3 billion (214)	65
\$750 million < \$1 billion (63)	72
\$500 < \$750 million (86)	68
\$250 < \$500 million (96)	55
\$100 < \$250 million (54)	55
< \$100 million (21)	53
All companies (778)	63

*Taken from IRRC’s study *Board Practices/Board Pay 2002*.

Arguments on economic impact

Whether one perceives a classified board structure to have a positive or a negative effect on shareholder wealth depends upon whether one believes that classified boards promote stability or entrenchment.

Proponents of staggered terms for directors argue that shareholders benefit from the structure because long-term company value depends on continuity and stability in governance, which, they say, is promoted by the staggered election of directors. Secondly, they argue that, as with other antitakeover devices, the staggered election of directors can provide the board of a target company with the power to negotiate a better deal for the shareholders if confronted by a potential acquirer.

Most staggered boards are divided into three classes, with one-third of directors elected each year. This means that dissidents cannot gain control of the board in any given year. Historically, companies that have faced shareholder resolutions on this subject have argued that classification of the board promotes continuity of experience on the board, provides for an orderly succession of directors and encourages any unsolicited bidder for control of the company to negotiate with the board, which can best represent the interests of all shareholders.

In a recent study of classified boards, Richard Koppes, Lyle G. Ganske and Charles T. Haag defend classified boards from a corporate governance standpoint by pointing out that the interests of shareholders and management are not inconsistent in regard to classified boards. In “Corporate Governance Out of Focus: The Debate Over Classified Boards,” which was published in the May 1999 edition of *Business Lawyer*, the authors argue that a company can provide value to shareholders through good corporate governance policies and high-quality professional directors, while at the same time having a classified board structure.

In addition, the study looks at the necessity of classified boards in today’s corporate environment. “In the past, classified boards may very well have been a tool used by management to prevent minority stockholder participation, but in today’s matured corporate environment, classified boards, at least in major U.S. companies, are more likely to promote the stability necessary for strategic, long-term planning.”

What proponents of classified boards call stability, opponents of classified boards call entrenchment. Critics argue that classified boards hurt shareholder value in two ways. First, by removing the threat of annual elections, opponents of classified boards argue that directors may lose their sense of accountability to shareholders and govern more in management’s interests than those of the shareholders. William Steiner, a long-time advocate of board declassification, has made this case in the supporting statement of his proposals: “I believe that the company’s classified board of directors maintains the incumbency of the current board and therefore of current management, which in turn limits management’s accountability to stockholders.” Similarly, the International Brotherhood of Teamsters argues that “reducing the frequency of director elections reduces the accountability of each director to shareholders and tends to insulate them from long-term shareholders’ interests.”

The second way a classified board could hurt shareholder value is by depriving shareholders of takeover premiums. The very same fact that leads companies to extol the virtues of a classified board—that it takes at least two years to effect a change to the majority of the board if only one-third of the directors are elected each year—is a principal concern of staggered board critics.

Aside from discouraging some potential acquirers and making change more difficult, a concerted proxy contest could lead to a year of division and controversy on the board.

Opponents of staggered terms generally say the provisions pose a barrier to control that depreciates the value of the company. If a company creates an effective barrier against nonconsensual tender offers or takeovers, shareholders are essentially disenfranchised. A number of critics of classified boards reject the argument that such provisions are the best way to give boards negotiating power to raise bids. Other provisions can provide preferable means of protecting all shareholders, they argue.

Classified boards can also damage shareholder rights at companies with cumulative voting in the election of directors, say critics. With fewer directors up for election in any given year, it takes a greater number of votes to get over the threshold for electing a single director.

Evidence

The evidence on the effect of staggered boards on shareholder value is ambiguous. While some studies show a significant negative effect on share value when firms adopt classified boards—especially in the 1980s—other studies show no effect on share value, or positive effects.

The ambiguity of the issue was highlighted last year in response to an academic study. The Bebchuck Study, compiled in late 2001 and conducted by three Harvard Law School professors, concluded that directors on staggered boards were much more likely to remain independent and block a value-increasing bid, and that staggered boards produced a loss of 8 to 10 percent of corporate value for target-company shareholders. Additionally, the authors found that companies with a majority of independent directors were not less likely to abuse defensive tactics and that staggered boards do not appear to obtain higher premia in negotiated transactions.

John C. Wilcox, writing for *Corporate Governance Advisor*, looking at the same study, concluded that staggered boards are, on the whole, in the interest of shareholders. The crux of their position lay in that “good governance is not synonymous with successful takeovers” and “the appropriateness of staggered boards is a matter of policy more than of economics”. The analysis points out that the Bebchuck Study includes only hostile deals and does not consider the accountability of acquiring company managers. The analysis criticizes the disregard of important long-term policy questions, believing that corporate governance efforts should instead be directed toward the issues of responsibility and director capacity in the hope of avoiding debacles such as occurred at Enron.

Among researchers skeptical that classified boards generally have negative effects is Victoria McWilliams, who says that examination of the stock price effect of antitakeover amendments for exchange-listed firms fails to identify “significant effects associated with the proposal of any type of antitakeover amendment.” Interestingly, though, McWilliams says those firms with large managerial ownership do not need classified board provisions to enhance their bargaining power in takeover situations when they lack such bargaining power. (*Journal of Applied Business Research*, Spring 1994. See also, Ali R. Malezadeh and McWilliams, *Journal of Applied Business Research*, Fall 1995.)

Chamu Sundaramurthy, Paula Rechner and Weiren Wang, who summarize research on classified boards in the Sept. 19, 1996 *Journal of Management*, reach a far more negative conclusion. The authors—opponents of classified board provisions—say that, “While initial empirical

investigations indicated that classified board provisions adopted in the 1970s had a minimal positive impact, subsequent studies have repeatedly shown that classified boards adopted in the 1980s had a significant negative impact.”

Whatever the generalized evidence, there can be little doubt that classified boards can have significant impacts on particular potential hostile takeovers. One of the most prominent recent debates concerns Moore’s hostile bid for Wallace Computer Services in 1995. Wallace’s classified board structure, along with its poison pill, played an important role in preventing Moore from succeeding, even though 73 percent of shareholders had tendered shares for Moore’s bid. Moore ran a tender offer and proxy contest simultaneously, and was unable to displace the board through the proxy contest because of Wallace’s classified board provision.

State law/regulatory

All states allow companies to classify their boards if they have a certain minimum number of directors. Most states authorize that number at nine. State limitations vary on the number of classes and the length of terms allowed. Most states authorize the classification of boards into three classes. Louisiana and New Jersey authorize director terms of up to five years, while other states allow for directors to be divided into two classes with two-year terms. Some states require that certain criteria be met if the company also allows for cumulative voting. For example, in Virginia and Washington, the combination of provisions is not permitted unless at least three directors are elected each year. Other variations include whether the board itself may adopt a classified structure or whether it must be approved by the shareholders. A majority of the states require that the provision be approved by shareholders. In some states, such as Louisiana, Pennsylvania, and now Maryland, the board can adopt a classified board on its own. One state, Massachusetts, mandates that companies have classified boards unless otherwise stated in the charter.

The Massachusetts provision, which was adopted in April 1990 as “emergency” legislation to save one in-state company—Norton—from a hostile takeover, automatically classified the boards of all companies incorporated in that state. It also prohibited the removal of directors without cause. Companies were allowed to opt out of the provision by a vote of the board. Since Jan. 1, 1992, companies may opt out of the provision by a two-thirds vote of the shareholders. After the law’s adoption, the proportion of Massachusetts companies covered by IRRC that had classified boards doubled.

In June 1999, the Maryland legislature passed the *Maryland Unsolicited Takeover Act*. This act, among other things, allows companies incorporated in Maryland to adopt classified board structures without obtaining shareholder approval. Institutional investors and shareholder activists have criticized the act for offering almost unqualified protection for incumbent directors and management, therefore entrenching management. (Approximately 1.8 percent of the companies in IRRC’s core research universe are incorporated in Maryland, and Maryland is a favorite state for real estate investment trusts.) After implementation of the act, some companies took advantage of the provision that allowed for classified boards without shareholder approval and adopted these structures.

In 1997, Georgia’s General Assembly considered a bill that would have automatically staggered the boards of all companies incorporated in the state. Invacare, a company based in Ohio, sought to replace the entire board of Georgia-based Healthdyne Technologies after a \$169.5 million cash tender offer for the company was rejected by the Healthdyne board. Healthdyne, seeking

protection from Invacare's proxy contest, lobbied Georgia's state legislature to pass a law that would have classified the boards of all Georgia companies. The proposal passed in the state's Senate, but was overwhelmingly rejected in the House. Ultimately, the bill died in a conference committee and was defeated.

A recently modified provision of California law allowed some California companies to adopt a classified board structure. Under California law, a company may amend its charter or bylaws to divide the board of directors into two or three classes when the company becomes a listed company. Previously, California law defined a listed company as one that, among other things, has at least 800 holders of equity securities. California law has been changed to remove the 800-holder requirement for listed companies. The amendment provides that California corporations may have a classified board, regardless of the number of shareholders it has, so long as it qualifies as a listed company.

While many companies are entitled to have classified boards under state law, the regulations under which the staggered system is provided for varies. Most often, states authorize a classified board provision in the company's charter. Twenty or so states, including Delaware, allow the provision to be in the charter, bylaws or both. Companies in Pennsylvania and Texas can provide for a classified board only through the bylaws. West Virginia law states that the articles of incorporation or a vote of the shareholders may provide for the staggered terms of directors.

The major U.S. stock exchanges also have a say in the structure of boards. For example, the New York Stock Exchange requires that some directors be elected each year, and that companies with classified boards have no more than three classes of directors with terms of office no longer than three years.

SEC positions

The Securities and Exchange Commission has consistently found that nonbinding classified board shareholder proposals are not excludable from proxy statements. Consequently, companies rarely challenge these proposals at the commission, except on technical grounds such as missed filing deadlines or duplication of proposals.

Binding shareholder proposals to amend charters and bylaws to declassify boards that were introduced during the 1999 proxy season resulted in new issues confronting the SEC. Companies questioned whether or not a binding charter or bylaw shareholder proposal could be included in a proxy statement. Because states vary on whether a classified board is provided for in the charter, bylaws or both, the circumstances regarding binding proposals vary.

Great Lakes Chemical, incorporated in Delaware, submitted a no action request to the SEC in regard to a binding charter amendment proposed by the New York City Employees' Retirement System (NYCERS) in 1999. The company claimed that such a proposal would violate Delaware law, which provides that only the company's board of directors may propose a charter amendment. In other words, a shareholder cannot put forth a charter amendment.

Great Lakes also argued that even if the proposal had been intended as a bylaw amendment, it would have additionally violated section 109 of the Delaware corporate law. Section 109 conditions that a company's bylaws may not be inconsistent with its charter. Since Delaware allows a company to accommodate for a classified board in both the charter and bylaws, as Great

Lakes has done, the company claimed that a bylaw amendment would violate its charter, which provides for a classified board.

The company was successful in its dispute. The SEC issued a no action letter permitting Great Lakes Chemical to exclude the proposal under rule 14a-8(i)(1), as an improper subject for shareholder action under applicable state law. In order to be considered at the company's annual meeting, the SEC determined that the proponents could have revised the proposal as a request, rather than a binding amendment. Nycers did not revise the proposal.

Fleming made a similar argument in regard to a binding bylaw proposal, referring to the laws of the state of Oklahoma. The company argued that if the proposal passed, its bylaws would be inconsistent with its charter. Under Oklahoma law, a company's charter and bylaws must be consistent. The SEC allowed Fleming to omit the proposal on the grounds that it violated Rule 14a-8(i)(2), which permits a company to omit a proposal if the proposal would violate any state, federal or foreign law. The ruling indicated that the bylaw amendment, if implemented, would violate the company's charter, which would in turn violate the Oklahoma state law. The proposal was withdrawn due to the company's agreement to put its classified board to a shareholder vote.

II. SHAREHOLDER PROPOSALS in 2002

Over the past five years, shareholder proposals requesting that companies repeal classified boards continue to be a leading subject, in terms of numbers as well as shareholder support. Predictably, classified board shareholder proposals are often submitted at companies that have demonstrated poor financial returns over a period of time.

The proposals are usually precatory, simply asking the board to end the staggered board system and provide for an annual election of all directors. Therefore, unless a company's charter specified otherwise, non-binding proposals usually require only a majority of the shares voted on the issue to pass, and are not binding on the board even if they do pass. As a result, it is rare for a company to take action following a shareholder proposal, regardless of the support generated by the proposal. Only one of the 31 companies that saw passage of a shareholder proposal to declassify board structure in 2001 followed with a management proposal to eliminate the classified board structure in 2002. The management proposal at KeyCorp was defeated receiving support from only 37.2 percent of the outstanding shares.

Thirteen of the 42 companies that had a classified board shareholder proposal come to a vote in 2002 faced similar proposals on at least four occasions in the past, and 31 of the 42 faced a proposal to declassify the board at least once previously (see table 5). Five of those companies have seen at least 10 classified board shareholder proposals in the past

The number of proposals submitted to companies requesting a declassification of the board continued to decline in 2002. In 2000 and 2001, IRRC tracked the submission of 72 and 55 similar proposals, compared to 51 proposals submitted in 2002. While fewer proposals were submitted over the three-year time period, the proportion of proposals that came to a vote increased. In 2000, 75 percent of the proposals submitted were voted on; in 2001 and 2002, more than 82 percent came to a vote.

Support for the classified board proposals reached record levels in 2002, with average support for such proposals registering at 61.6 percent of votes cast. The previous two years witnessed support

around 53 percent, while 1999 saw shareholder support for such proposals registering at under 50 percent.

Of the 42 classified board shareholder proposals voted on in 2002, 37 proposals received support from more than a majority of the votes cast. Only one of these proposals did not pass, at Ralcorp Holdings. The proposal at Ralcorp Holdings received support of 50.4 percent of the votes cast for and against but failed to pass nonetheless. This is because the company's vote requirement included abstentions in the total, which had the effect of counting against the proposal. (As calculated by the company, the proposal received support from less than 50 percent of the votes cast.)

The use of binding shareholder proposals on board declassification has not proven to be as effective or as abundant as on other types of shareholder proposals, such as those relating to poison pills and option repricing. No binding classified board proposals were scheduled to come before shareholders in either 2002 or 2001. A binding proposal at Kmart in 2000 received support from 68.5 percent of the votes cast, but did not pass because support from 58 percent of the outstanding shares was necessary for approval. Another binding proposal at Kmart in 1999 received support from 62.6 percent of votes cast. Kmart did not challenge the binding proposals at the SEC. Michigan, Kmart's state of incorporation, allows shareholders to amend a company's charter without the approval of the board (see state law/regulatory).

The New York City Funds submitted a binding charter amendment resolution to Great Lakes Chemical in 1999, but the proposal was omitted after the SEC issued a no action letter, which determined that the resolution was an improper subject for shareholder action under applicable state law. In 2000, Great Lakes was confronted with a shareholder proposal to repeal its classified board again, and Nycers sponsored a "vote no" campaign against the company's slate of directors up for election. The pension fund says approximately 27 percent of the shareholders at Great Lakes Chemical withheld votes for management's slate of two directors. A classified board proposal at the company in 2001 passed, receiving 55.3 percent of the votes cast.

2002 voting results

Shareholder proponents submitted a total of 51 resolutions to repeal classified boards in 2002, with 42 of the proposals actually coming to a vote. The average vote for the presented proposals was 61.6 percent of the votes cast. Nearly 90 percent of the proposals received support from at least a majority of the votes cast. The percentage of classified board shareholder proposals that receive majority support continues to increase. In 2001, 70 percent of the proposals voted on received majority votes, up from X percent in 1996.

Table 3 identifies the 2002 classified board shareholder proposals, the proponents of each proposal and the outcome of the proposal. Unless otherwise indicated, the shareholder proposal required support from a majority of the votes cast. All outcome percentages are based on a majority of votes cast for and against.

Table 3: 2002 shareholder proposals to repeal classified boards

(see last page for key to acronyms)

Company	Sponsor	Proposal status/voting support* (%)	Passed ?
Airborne	Teamsters	84.5	yes ¹
Albertson's	NYC Teachers	omitted	
Albertson's	Armstrong, G.	61.0	yes ¹
Allegheny Energy	Gilberts	55.5	yes
Baker Hughes	Mathis, H.	81.5	yes ¹
Bausch & Lomb	AFSCME	76.5	yes ¹
Boeing	Chevedden, J.	50.5	yes ¹
Boise Cascade	Osborn, J.	80.4	yes
Bristol-Myers Squibb	Davis, E.	69.3	yes ¹
Delphi	Rossi Family	63.4	yes
Delta and Pine Land	NYCERS	not presented	
Documentum	NYC Police	60.5	yes ¹
Federated Department Stores	Davis, E.	88.5	yes
FirstEnergy	Chevedden, J.	59.3	yes ¹
Freeport McMoRan Copper & Gold	Mathis, H.	79.1	yes ¹
Gateway	Calpers	33.2	no
Gerber Scientific	NYC Fire	71.9	yes
Gillette	NYCERS	55.7	yes
Goldman Sachs Group	Davis, E.	24.8	no ²
Goodyear Tire & Rubber	NYC Teachers	74.4	yes ²
Great Lakes Chemical	AFSCME	79.4	yes ¹
Greater Bay Bancorp	Armstrong, G.	53.5	yes
Hasbro	NYC Teachers	58.9	yes ¹
Host Marriott	Davis, E.	36.8	no ³
Kerr-McGee	AFSCME	not in proxy	
KeyCorp	Armstrong, G.	withdrawn	
Kroger	Teamsters	67.8	yes
Lucent Technologies	Davis, E.	59.3	yes ¹
May Department Stores	Davis, E.	62.5	yes ¹
Maytag	Chevedden, J.	57.1	yes ¹
McDermott International	Conn. Ret. Plans	withdrawn	
Merck	Davis, E.	62.6	yes
Morgan Stanley Dean Witter	Davis, E.	65.3	yes ¹
PacifiCare Health Systems	NYC Police	69.1	yes ¹
PEPCO Holdings	Davis, E.	meeting cancelled	
Pharmacia	Sifferman, T.	71.8	yes ¹
PPG Industries	Teamsters	omitted	
Ralcorp Holdings	Calpers	50.4	no
Raytheon	Steiner, W.	61.9	yes
Reebok International	Conn. Ret. Plans	54.1	yes
Saks	NYCERS	32.9	no
Sears, Roebuck	Glotzer, M.	68.7	yes
Sempra Energy	Rossi Family	omitted	
Southwest Airlines	Greenwood, L.	59.2	yes
Spartan Motors	Ivan, M.	withdrawn	
Starbucks	Operating Eng.	35.7	no

Company	Sponsor	Proposal status/voting support* (%)	Passed ?
Starwood Hotels & Resorts Worldwide	Davis, E.	77.8	yes
Sysco	Teamsters	60.1	yes ¹
VF	LongView	54.9	yes
Weyerhaeuser	Naylor, B.	55.9	yes
Wisconsin Energy	NYCERS	59.8	yes
Average vote for 42 proposals		61.6	

¹The company included abstentions in the vote total.

² Proposal required support from a majority of the outstanding shares.

³ Proposal required support from two-thirds of outstanding shares.

Some shareholder activists argue that companies should take action if a shareholder proposal receives majority support, especially for two consecutive years. The New York Pension Funds and the Council of Institutional Investors have taken initiatives to urge companies to comply with the requests made in these proposals (see Proposals Anticipated in 2003). The Council suggests that companies comply after a shareholder proposal receives majority support the first time (the policy previously suggested this after two years of majority support). Calpers also suggests that a company put a binding management proposal up to vote at the next annual meeting following the first time that the proposal garners support from more than a majority, or submit reasons as to why the proposal was not implemented.

However, as previously discussed, few companies respond to majority votes. One company, KeyCorp, asked shareholders to approve a charter amendment to declassify the board after a shareholder proposal to request declassification had received at least majority support in three of the previous four years. The proposal failed to garner even 40 percent of the outstanding shares.

Table 4 identifies the companies that have had proposals that received at least a majority support on more than one occasion and the years on which the high vote was received.

Proposals at Host Marriot and Sears have not received support from at least a majority of shareholders for two consecutive years, even though proposals requesting these companies declassify their boards have been put to a vote 15 and 10 times, respectively. In 2002, for the first time, the proposal at Sears did receive majority support, tabulating 68.7 percent of the votes cast.

Table 4: 2002 Classified board shareholder proposals receiving majority support in multiple years

Company	Number of years (including 2002)	Years proposals received at least a majority support
Airborne	4	1999, 2000, 2001, 2002
Albertson's	2	2001, 2002
Allegheny Energy	2	2001, 2002
Baker Hughes	2	2001, 2002
Boise Cascade	3	2000, 2001, 2002
Delphi	2	2001, 2002
Bristol-Myers Squibb	6	1997, 1998, 1999, 2000, 2001, 2002
Federated Department Stores	4	1998, 2000, 2001, 2002
FirstEnergy	3	1999, 2001, 2002
Freeport McMoRan Copper & Gold	3	2000, 2001, 2002
Goodyear Tire & Rubber	2	2001, 2002

Company	Number of years (including 2002)	Years proposals received at least a majority support
Great Lakes Chemical	4	1998, 2000, 2001, 2002
Kroger	4	1999, 2000, 2001, 2002
Lucent Technologies	2	2001, 2002
May Department Stores	3	2000, 2001, 2002
Maytag	4	1999, 2000, 2001, 2002
Merck	4	1999, 2000, 2001, 2002
Raytheon	3	2000, 2001, 2002
Southwest Airlines	2	2001, 2002
Starwood Hotels & Resorts Worldwide	3	2000, 2001, 2002
Sysco	2	2001, 2002
Wisconsin Energy	2	2001, 2002

Of the shareholder proposals that came to a vote in 2002, 11 proposals received over 70 percent of the votes cast. The proposal receiving the highest support from shareholders was Federated Department Stores, where 88.5 percent of the votes cast were in support of the proposal. This is the third year in a row the proposal received over a majority of the votes cast. The proposal at Federated Department Stores received support from more than 70 percent of votes cast in the two previous years, and in 1998, when management did not make a voting recommendation, a proposal calling for the declassification of the board registered support of nearly 85 percent of the votes cast.

The proposal that received the second highest vote of approval was at Airborne, the fourth consecutive year that the proposal has achieved majority support. The proposal received support from 84.5 percent of the votes cast. The company's shareholders approved the proposal in 2001 with 76.0 percent of the votes cast, and in 2000 with 78.3 percent of the votes cast. (See Proposals Anticipated in 2003.)

Insiders or majority shareholders can abet low levels of voting support for shareholder proposals. Average director and officer holdings at the companies with the ten lowest levels of support was greater than 10 percent, while ownership at the companies with the ten highest levels of support was approximately half that number.

Individuals just more than half of the declassification proposals in 2002. Evelyn Y. Davis sponsored 10 of these proposals, of which nine made it to a shareholder vote. Of the nine proposals, seven received support from at least a majority of the votes cast. The average vote for her nine sponsored proposals was 60.8 percent of the votes cast. Davis tends to target the same companies year after year. Four of the companies have been pursued for at least five years.

Table 5 identifies the shareholder proposals that came to a vote in 2002, sorted in descending order by the level of support received on each proposal. The chart also includes the number of past classified board shareholder proposals voted on at the company, and the director and officer and institutional holdings in the company.

Table 5 also identifies whether the company has a shareholder rights plan in place. The combination of a classified board and a poison pill serves as a very powerful anti-takeover device, and many institutional investors do not support this combination. A dissident group would be required to win virtually all board seats up for election at two consecutive annual meetings in order to control a majority of the board and redeem the company's poison pill. This is a process few groups are willing to endure due to the time and expense of completing such a maneuver.

Table 5: Shareholder proposals to repeal classified boards sorted by level of voting support: 2002

Company	Vote for (%)	Number of past proposals¹	Institutional holdings (%)	Director and officer holdings (%)²	Poison pill
Federated Department Stores	88.5	3	96.4	less than 1%	yes
Airborne	84.5	3	68.2	4.7	no
Baker Hughes	81.5	2	86.2	less than 1%	no
Boise Cascade	80.4	4	89.2	5.9	yes
Great Lakes Chemical	79.4	3	84.4	3.7	no
Freeport McMoRan Copper & Gold	79.1	4	48.0	24.2	yes
Starwood Hotels & Resorts Worldwide	77.8	2	86.3	4.7	yes
Bausch & Lomb	76.5	2	85.5	4.5	no
Goodyear Tire & Rubber	74.4	1	63.6	less than 1%	yes
Gerber Scientific	71.9	0	65.1	6.7	no
Pharmacia	71.8	0	69.5	less than 1%	yes
Bristol-Myers Squibb	69.3	15	59.7	less than 1%	no
PacifiCare Health Systems	69.1	0	2.8	4.7	yes
Sears, Roebuck	68.7	10	71.9	less than 1%	no
Kroger	67.8	5	70.8	less than 1%	yes
Morgan Stanley Dean Witter	65.3	2	50.1	2.4	yes
Delphi	63.4	1	67.6	less than 1%	yes
Merck	62.6	13	55.2	less than 1%	no
May Department Stores	62.5	14	73.3	less than 1%	yes
Raytheon	61.9	3	68.6	less than 1%	yes
Albertson's	61.0	7	66.8	2.1	yes
Documentum	60.5	0	88.2	8.8	no
Sysco	60.1	1	66.1	less than 1%	yes
Wisconsin Energy	59.8	3	49.2	1.6	no
FirstEnergy	59.3	4	53.4	less than 1%	yes
Lucent Technologies	59.3	4	29.0	less than 1%	yes
Southwest Airlines	59.2	1	73.3	2.0	yes
Hasbro	58.9	0	76.0	12.7	yes
Maytag	57.1	4	55.1	6.1	yes
Weyerhaeuser	55.9	3	66.6	4.6	no
Gillette	55.7	0	62.0	9.7	Yes
Allegheny Energy	55.5	1	41.1	less than 1%	yes
VF	54.9	0	86.2	23.0	yes
Reebok International	54.1	3	77.1	5.6	yes
Greater Bay Bancorp	53.5	0	42.8	6.3	yes
Boeing	50.5	4	63.4	2.0	no
Ralcorp Holdings	50.4	0	73.8	3.9	yes
Host Marriott	36.8	15	62.1	11.2	yes
Starbucks	35.7	0	60.5	6.3	no
Gateway	33.2	0	45.5	32.9	yes
Saks	32.9	1	52.0	9.8	yes
Goldman Sachs Group	24.8	1	29.3	4.5	yes

¹ Proposal presented in 2002 is not included.

² Indicates percent of voting power controlled by directors and officers as of the record date of the annual meeting held in 2002.

III. MANAGEMENT PROPOSALS IN 2002

Eleven companies sought shareholder approval to adopt classified boards in 2002, which is roughly the same as in 2000 when 10 companies put the classification of their boards on the ballot. However, in 2001 and 1999 there were 20 and 21 classification proposals, respectively.

The number of companies adopting (or attempting to adopt) classified boards continues to outpace those attempting to eliminate their classified board structure. In 2002, as in the two previous years, only seven companies asked for shareholder approval to repeal their classified boards, while 13 did so in 1999.

Unlike the outcome of shareholder proposals to repeal classified boards, which are calculated based on a majority of the votes cast, IRRC has calculated the management proposals based on each individual company's voting requirement. Because of the different voting methods, average votes for and against cannot be calculated.

Adoption of classified boards

Shareholder approval is usually required to institute the staggered election of directors. Shareholder approval to adopt classified boards was sought at 11 companies in 2002, (see Table 6). Shareholder support for such moves, which strengthens a company's takeover defenses, has become more difficult to come by in recent years. Proposals at 15 of the 49 companies in IRRC's core research universe (approximately 30 percent) that sought to classify their boards from 1994 to 2002 were defeated. (IRRC had about 1,500 companies in its core research universe from 1994 to 1996, and has had about 2,000 companies in each year since.) However, all five of the companies in IRRC's core universe that had management proposals to adopt classified boards in 2002 received sufficient shareholder support to do so. This compares to three of six such proposals passed by shareholders in 2001. (In 2002, proposals at five additional companies outside of IRRC's 2002 core research universe also passed.)

In connection with board classification proposals, companies often seek approval for additional anti-takeover defenses that would tighten the possible avenues a hostile suitor could take to gain control of the company. A number of companies that put forth management proposals to adopt classified boards in 2002 also sought approval for other anti-takeover provisions. Most prevalent were proposals to eliminate written consent. Of the 11 companies which sought to adopt a classified board structure in 2002, six (Green Mountain Coffee, Marvel Enterprises, Reader's Digest Association, Seacoast Banking Corp. of Florida, Vital Signs and Wm. Wrigley Jr.) also submitted proposals to eliminate written consent.

The proposals to adopt classified boards at Reader's Digest Association coincided with amendments to amend their respective equity structures. The proposal at Reader's Digest was presented in connection with a proposal to combine the company's voting and non-voting common stock into a single class of common stock, thereby increasing the voting power of the public shareholders.

Table 6: Management proposals to adopt classified boards: 2002

Company	Vote for	Vote against	Abstentions	Status/ Passed ?	Vote required
Ceres Group ¹	68.0	31.9	0.1	yes	majority votes cast
Green Mountain Coffee ¹	56.9	18.1	0.0	yes	majority outstanding
Marvel Enterprises ¹	n/a	n/a	n/a	yes	majority outstanding
Old National Bancorp	85.9	14.1	0.0	yes	majority votes cast
Reader's Digest Association	84.5	4.4	0.4	yes	majority outstanding (class B only)
Seacoast Banking Corp. of Florida ¹	73.5	11.1	n/a	yes	two-thirds outstanding
Vital Signs	76.0	24.0	0.0	yes	majority votes cast
Wilson's The Leather Experts ¹	69.7	30.2	0.1	yes	majority votes cast
Wrigley (Wm.) Jr.	88.6	10.8	0.6	yes	majority votes cast
Zebra Technologies	62.5	24.1	0.0	yes	majority outstanding
Zygo ¹	35.1	41.9	23.0	no	majority votes cast

¹The company was not in the IRRC core research universe in 2002.

Elimination of classified boards

Seven companies in IRRC's research universe asked shareholders to eliminate classified board structures in 2002 (see Table 7), which is the same number of companies that sought similar approval in both 2001 and 2000. Three of six proposals for which voting results are available have passed thus far.

In 2002, one company, KeyCorp, responded to a shareholder proposal requesting declassification of the board that received majority support in 2001. The management proposal at KeyCorp, which required 75 percent of outstanding shares to pass, received support from just 37.2 percent of shareholders.

Several other companies submitted management proposals to declassify boards in 2002 as a result of other shareholder concerns (i.e., the proposals were not submitted as a direct result of a majority vote on a shareholder proposal). Waste Management declassified its board as part of the settlement of a class action lawsuit where the lead plaintiff was the Connecticut Retirement Plans and Trust Fund. That proposal passed receiving support from 78.3 percent of outstanding shares. Additionally, Lone Star Steakhouse & Saloon allowed its shareholders to vote on a management proposal to declassify the board following a proxy fight in which a dissident director was elected to the board. The proposal at Lone Star did not pass. The proposal required 80 percent of outstanding shares to pass, but garnered support from only 61.3 percent of shareholders. (In 2000, a shareholder proposal to declassify the board at Lone Star received approval from 69.3 percent of the votes cast.)

Other companies that previously responded to high votes on shareholder proposals include Health Net in 2001 and Home Depot, Cendant and Silicon Graphics in 2000. The management proposals at Health Net and Home Depot passed; however, the proposals at Cendant and Silicon Graphics did not. Cendant will sponsor another management proposal to declassify its board in 2003.

Table 7: 2002 management proposals to repeal classified boards

Company	Vote for	Vote against	Abstentions	Status/ Passed?	Vote required
Cendant	70.1	2.3	0.5	no	80% outstanding
Clarus [†]	n/a	n/a	n/a	awaiting vote	2/3 outstanding
CoBiz [†]	76.1	1.6	0.1	yes	75% outstanding
KeyCorp	37.2	33.7	1.5	no	75% outstanding
Lone Star Steakhouse & Saloon	61.3	10.2	0.1	no	80% outstanding
Unifi	62.1	0.2	0.0	yes	majority outstanding
Waste Management	78.3	0.4	0.5	yes	2/3 outstanding

[†]The company was not in the IRRC core research universe in 2002.

IV. PROPOSALS ANTICIPATED FOR 2003

Management proposals

Four companies have made it known that they intend to submit management proposals to repeal their classified board structure in 2003 in response to prior shareholder activism. Management proposals at Bristol-Myers Squibb, Great Lakes Chemical and PacifiCare Health Systems come after a shareholder proposal calling for the declassification of the board was approved by a majority of votes cast in 2002. Bristol-Myers Squibb had been targeted by Evelyn Davis each year since 1987. Great Lakes Chemical had been targeted since 2000 and additionally in 1998, with the proposal garnering majority support on each occasion—79.4 percent most recently. PacifiCare is responding to a first time shareholder proposal on the issue, which received support from 69.4 percent of votes cast.

The fourth company, Cendant, sought to declassify its board two times since 2000, in part in response to a shareholder that received majority supported in 1999. However, the management proposals, which required support from 80 percent of the outstanding shares, did not pass. Cendant will again submit a management proposal for declassification in 2003.

Additionally, Airborne's board decided in early 2003 to repeal its classified board structure, effective immediately following the company's 2003 annual meeting. The declassification is not subject to shareholder approval because the classified board provision exists in Airborne's bylaws. Airborne is incorporated in Delaware, which allows boards of directors to amend bylaws without shareholder approval if permitted under a company's charter. (Most classified board provisions are included in charters, which generally cannot be amended without shareholder approval.) Airborne had been targeted with a classified board shareholder proposal annually since 1999. Most recently, in 2002, the proposal received support from 84.5 percent of votes cast.

Shareholder proposals

Shareholder resolutions to repeal classified boards will continue to be prominent in 2003. IRRC is tracking more than 46 such proposals for 2003 (see Table 8). Proponents include individuals, large public pension funds, and union groups.

Individual proponents are leading the way, sponsoring 25 of the 46 proposals. Evelyn Y. Davis has submitted 13 of these resolutions; she submitted 10 declassification proposals in 2002. Host Marriott has been targeted by Davis each year since 1987 and May Department Stores, since 1988. Additionally, Davis has submitted a proposal to declassify the board at Merck each year from 1988 through 1994 and from 2000 through 2002. Her proposal to declassify the board at Starwood Hotels & Resorts Worldwide has been submitted for the fourth consecutive year, having won majority support on each prior occasion.

Walden Asset Management will sponsor declassification proposals in 2003 for the first time. Walden had previously focused primarily on social issues. So far, Walden has submitted five proposals calling for the declassification of corporate boards.

The LongView Fund also has submitted five proposals calling for the annual election of directors. Throughout 2002, LongView sponsored only one such shareholder proposal.

The New York Funds have submitted five proposals asking for board declassification for 2003. In addition, the New York Funds are targeting companies that did not respond to previous shareholder proposals to repeal classified boards that received majority support. The Funds are requesting that boards adopt a policy to deal with shareholder proposals that receive majority support. Companies that have received this proposal include Gillette, Goodyear Tire & Rubber and Wisconsin Energy.

Table 8: Shareholder proposals to repeal classified boards: 2003

(see last page for key to acronyms)

Company	Sponsor	Status
Airborne (binding)	Teamsters	withdrawn
Alaska Air	Richner, W.	5/20/2003
Avon Products	Walden	May
Bausch & Lomb	AFSCME	April
BJ's Wholesale Club	Walden	May
Boeing	Chevedden Family Trust	4/28/2003
Boston Properties	Davis, E.	May
Bristol-Myers Squibb	Davis, E.	withdrawn
CarrAmerica Realty	Davis, E.	May
Covance	NYCERS	May
Crescent Real Estate Equities	SEIU	June
Delphi	Rossi Family	5/1/2003
Dow Jones	CWA Member Davis, E.	4/16/2003 4/16/2003
Federated Department Stores	Davis, E.	May
FirstEnergy	Chevedden Family Trust	May
Gillette	Walden	5/15/2003
Goldman Sachs Group	Davis, E.	4/1/2003
Honeywell International	Chevedden Family Trust	4/28/2003
Host Marriott	Davis, E.	May
IMS Health	Rossi Family	5/2/2003
Luby's	Mathis, H.	1/31/2003
Lucent Technologies	Davis, E.	2/19/2003
Manor Care	NYC Fire	May
May Department Stores	Davis, E.	May

Company	Sponsor	Status
Maytag	Chevedden Family Trust	5/8/2003
McDonald's	Walden	May
Merck	Davis, E. Walden	4/22/2003 4/22/2003
Meristar Hospitality	NYC Police	May
Paccar	LongView	April
PEPCO Holdings	Davis, E.	4/25/2003
Procter & Gamble	Davis, E.	10/14/2003
Raytheon	Wolff, A.	4/23/2003
Reebok International	Conn. Retirement Plans	5/6/2003
Safeway	LongView	May
Saks	NYCERS	June
Sempra Energy	Rossi Family	May
Stanley Works	Conn. Retirement Plans	4/22/2003
Starwood Hotels & Resorts Worldwide	Davis, E.	May
Steris	NYC Funds	July
Tellabs	LongView	April
VF	LongView	April
Weyerhaeuser	Naylor, B.	4/15/2003
Whole Foods Market	LongView	3/31/2003
Xcel Energy	Armstrong, G.	4/30/2003

KEY TO SHAREHOLDER PROPONENTS AND COORDINATORS

AFSCME	American Federation of State, County & Municipal Employees
Calpers	California Public Employees' Retirement System
Conn. Ret. Plans	State of Connecticut Retirement Plans
CWA	Communications Workers of America
Gilberts	John J. Gilbert and associates
LongView Fund	LongView Collective Investment Fund
NYCERS	New York City Employees' Retirement System
Operating Engineers	International Union of Operating Engineers
SEIU	Service Employees International Union
Teamsters	International Brotherhood of Teamsters
Walden	Walden Asset Management

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