



IRRC

# IRRC Corporate Governance Service 2003 Background Report D:

## DIRECTOR PAY

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Executive summary	p.1
Views on director pay	p.2
Director pay practices	p.3
Disclosure	p.6
Stock plans for directors	p.6
Shareholder proposals	p.7
Proxy voting guidelines	p.8
Appendix 1: Proposals to adopt director stock option plans, 2000-2002	p.11
Appendix 2: Proposals to add shares to director stock option plans, 2000-2002	p.12
Appendix 3: Proposals to adopt or add shares to director stock award plans, 2000-2002	p.13
Appendix 4: Shareholder proposals related to director pay, 1998-2002	p.14

### Executive Summary

Compensation for non-employee directors receives little scrutiny from shareholders in comparison with such issues as board independence and potential equity dilution. Nevertheless, director pay is an integral part of a company's corporate governance policy. Since the mid-1990s, many companies have altered their compensation practices in order to treat directors less like employees and more like shareholders. In addition to eliminating employee-like benefits, such as pension plans and insurance, companies have complemented cash compensation with stock, restricted stock, or options to purchase stock so that directors' interests might be more closely aligned with those of shareholders. To many shareholder activists, this trend was an encouraging sign of increased accountability in the boardroom. For the directors involved, the trend coincided favorably with the run-away bull market of the late 1990s. For companies, particularly those in the emerging technology sector, the opportunity to save some cash by doling out equity instruments, expense-free stock options in particular, was equally attractive. For a time, it appeared that everyone benefited from the new model.

The drawbacks of equity-based compensation are more transparent in less robust economic times. Some argue that too much emphasis on stock price may encourage directors to support high risk, "bet-the-bank" growth strategies that have greater consideration for short-term prospects than the long-term outlook. Equity-based compensation may also have an unintended influence on the amount of time and energy spent on director responsibilities. A board member who realizes substantial gains before a significant downturn in the company's stock price is less inclined to remain closely involved in company affairs, and by extension, the fate of shareholders who are still vested in the company. On the other end of the spectrum, a director who has nothing but underwater options to show for years of dedication may be difficult to retain.

Detractors of equity-based compensation for directors might point to the example of Enron. As of the company's 2001 proxy statement, the median number of shares beneficially owned by non-employee directors was 22,799. Even when the company's stock price was trading at \$45 (half of its all-time high), this median represented a face value of over \$1 million. By conventional wisdom, directors having this amount of money at stake would pay close attention to the fundamental financial health of the company. But detractors might argue that as Enron's stock price

continued to ascend year after year, a large equity interest might have influenced directors *not* to scrutinize the inner-workings of what, for a long period of time, appeared to be a proven business model. Could Enron's boom-and-bust history have been averted if disinterested directors had been in charge of oversight?

Many companies seeking to retain the full commitment of highly qualified board members face tough decisions on whether to revert towards the dependability of cash compensation or abide by the equity-centric model. Companies will also consider whether their director compensation packages are in accordance with the renewed emphasis recently placed on active engagement in company affairs, particularly on the part of committee chairpersons.

IRRC's latest annual survey of board compensation examines 1,245 S&P 1500 companies and shows that ninety percent pay an annual board retainer, the average value of which is \$29,350. The average board meeting fee among the 76 percent paying one is \$1,468. Seventy-four percent of all companies grant some type of stock option to directors, up from 70 percent in 2001. The average value of an annual option grant is \$64,758 using the methodology of multiplying the number of underlying shares by the fiscal year-end share price, and dividing the product by three. The average value of an annual long-term stock award is \$34,669. Only 24 percent of all companies employ some type of long-term stock award. Only 5 percent of all companies have an active retirement plan for directors; 10 percent provide life, health, or travel insurance coverage.

During 2002, IRRC tracked 356 proposals at S&P 1500 companies for which the company sought to adopt or add shares to a stock option plan in which directors could participate. The average opposition to such proposals was 22.1 percent. By comparison, IRRC tracked 325 similar proposals in 2001. Their average opposition was 23.2 percent.

Shareholder proposals related to director pay have declined substantially since 1996. In 2002, IRRC tracked only two proposals, each requesting that directors be paid in stock. Neither the proposal at Boeing nor the proposal at General Motors garnered the support of more than 10 percent of votes cast. IRRC tracked five shareholder proposals during 2001 related to director compensation.

## **Views on director pay**

*The Report of the National Association of Corporate Directors' Blue Ribbon Commission on Director Compensation* had a significant impact on director pay practices when it was released in 1995. A key tenet of the report maintained that director compensation should not be used only to attract and retain quality individuals, but also to motivate them. To do this, director compensation packages should focus on stock. Cash should take a secondary role, and benefit programs, such as retirement plans, should have no role whatsoever. While not ruling out the usefulness of stock options altogether, the report warned that a heavy reliance on stock options could tilt directors' outlook towards the short-term. Moreover, in contrast with shareholders, recipients of option grants are insulated from negative returns. They will either realize a gain through the exercise the option or, in the worst-case scenario, break even by simply allowing the option to expire. To emphasize the value of long-term stock price appreciation, the report advocated substantial stock ownership targets (under which stock options would not count) and the use of time-lapsing restrictions on the sale of stock.

To no surprise, the concept of linking directors' wealth with stock price performance gained considerable popularity during the bull market of the late 1990s. A 1997 report released by The Business Roundtable (an association of CEOs), entitled *Statement on Corporate Governance* suggested aligning the interests of directors and shareholders "by including some form of equity, such as stock grants or options, as a portion of each director's compensation". In hindsight of the disappointing shareholder returns of the recent past, some have voiced concern that director compensation may have become too heavily dependent on short-term performance. According to IRRC's most recent study, three in four companies grant stock options to directors, but only one in four issues some type of long-term stock award (such as restricted stock, deferred stock, or stock units). The scandals of Enron and Worldcom may have spawned a greater resolve to keep short-term pay under control. In May 2002, The Business Roundtable, which has always supported a balance between short-term and long-term compensation, specified in *Principles of Corporate Governance* that "equity compensation should be carefully designed to avoid unintended incentives, such as an undue emphasis on short-term market value changes."

"The way we govern now," published January 11, 2003 by *The Economist*, highlights the current difficulty of recruiting suitable candidates for the boardroom. Large companies are limiting senior executives from serving on more than one other board. Due to the Sarbanes-Oxley Act and the listing requirements of major stock exchanges, the amount of time that a board member must devote to his or her duties is on the rise. In addition, shareholder lawsuits are up in both frequency and size, which may lead some to think twice before joining a board. A smaller

pool of board candidates may lead to more enticing pay packages. A February 2003 survey by compensation consulting firm Hewitt Associates reports that 38 percent of 70 large U.S. corporations anticipate raising board retainers within one year; 31 percent plan to raise fees paid to committee chairpersons. The survey, entitled “Timely Topics Study on Corporate Governance”, finds that the majority of the companies planning to make changes in director compensation practices are doing so “in recognition of the greater demands on directors”.

A study released in September 2002 investigated the relationship between director compensation and CEO compensation. From a sample ranging between 740 and 855 companies between 1992 and 1999, authors Ivan E. Brick, Oded Palmon, and John K. Wald of Rutgers University suggest that excessive director compensation may be associated with excessive CEO compensation. The study, entitled *CEO Compensation, Director Compensation, and Firm Performance: Evidence in Cronyism*, also suggested a link between excessive director compensation and low company performance.

A May 2000 article in *California Management Review* by Donald Hambrick and Eric Jackson added quantitative armor to the long-held presumption that successful companies tend to have directors with high stakes in the company’s success. The article showed a positive correlation between directors’ equity holdings and shareholder returns over a ten-year period. Directors of “star” companies (those outperforming their respective business sectors) initially held a median amount of equity valued at more than five times that of directors’ holdings at underperforming companies. Hambrick and Jackson found the correlation most significant when directors invested their own resources to establish large equity positions.

In “Director Compensation: A Realistic View,” published in the November 2000 issue of *Director’s Monthly*, Douglass List drew on his experience as a lead outside director assisting the chairmen/CEOs of three companies to set director compensation packages. The article suggests that a director compensation package should be used to communicate the company’s values and expectations to directors. According to List, director compensation should take into account the time spent on actual board operations, for which cash fees are most appropriate; “attention time”, or “standby readiness”, for which a stock retainer is most appropriate; and the company’s demand for stock price appreciation, for which stock options are most appropriate.

In 1999, Tod Perry investigated the effects of incentive compensation (i.e., stock or stock options) on board activity in the paper “Incentive Compensation for Outside Directors and CEO Turnover.” Perry found that when predominantly independent boards are paid with incentive compensation, the likelihood of CEO turnover following poor company performance increases. From this, Perry concluded that incentive compensation apparently raises the monitoring efforts of independent boards.

## Director pay practices

The following information derives from IRRC’s *Board Practices/Board Pay: 2002*. The study covers 1,245 companies divided into three S&P indices, 10 revenue groups and 10 economic sectors. The following information pertains to 433 S&P 500 companies, 336 MidCap companies, and 476 SmallCap companies, all of which held annual meetings between Jan. 1, 2002 and July 31, 2002.

### Board retainers

By IRRC methodology, a retainer may include cash or unrestricted common stock. Since 2001, the value of the average annual retainer at S&P 500 companies increased by 4 percent. The average MidCap retainer grew by approximately 6 percent and the average SmallCap retainer grew by 3 percent since 2001.

**Table 1: Average retainer values among S&P indices, 2002**

Index	% paying retainer	Average retainer
S&P 500	94%	\$40,295
MidCap	92%	\$26,293
SmallCap	86%	\$20,862
All study companies	90%	\$29,350

Of the 190 companies in the study with a non-employee board chairperson, almost half pay an additional fee to that person. The average board chair fee as of 2002 is \$121,646.

## Board and committee meeting fees

Since 1997, the prevalence of board meeting fees at S&P 500 companies has fallen from 83 percent to 72 percent. That said, those that do pay a board meeting fee are paying more each year. The average board meeting fee increased by 4 percent since 2001.

**Table 2: Average board meeting fee values among S&P indices, 2002**

Index	% paying retainer	Average board meeting fee
S&P 500	72%	\$1,623
MidCap	79%	\$1,373
SmallCap	78%	\$1,405
All study companies	76%	\$1,468

Seventy-two percent of companies in the study pay a fee for each meeting of a key committee, such as the audit or compensation committee. The average fee paid is \$1,041—about 41 percent less than the average board meeting fee. Only about one in 10 companies pay committee retainers, which average \$7,718 per committee. S&P 500 companies are the least likely to employ committee meeting fees, but the most likely to employ committee retainers.

To acknowledge committee leadership, 56 percent of study companies pay an additional fee or retainer to key committee chairpersons. With 70 percent prevalence, S&P 500 companies are by far the most likely to employ committee chair fees. This percentage has dropped from 76 percent in 1997, but it is anticipated that committee chair fees will receive more consideration in the near future to compensate for the new expectations placed on committee leaders by recent legislation and stock exchange listing requirements.

To keep meeting fees under control, twelve percent of study companies use a “same-day” policy with regard to duplicate meetings held on the same day. For example, if a director attends a board meeting in the morning and a compensation committee meeting in the afternoon, he or she will receive either one flat fee for the entire day or a reduced fee for the second meeting held on the same day. Same-day policies are most common in the SmallCap sector.

## Director discretion

Many companies adopt flexible pay packages so that directors who want to increase their equity holdings may have the tools to do so. Nine percent allow directors to take options instead of cash. Twelve percent of study companies allow directors to take unrestricted stock for cash, and 33 percent permit directors to take restricted or deferred shares for cash. Approximately 6 percent of all companies in the study provide directors an added equity incentive, or kicker, to entice directors to choose stock instead of cash.

## Stock options

Slightly more than two-thirds of all companies now use an annual stock option grant in their director pay package. Only one-third make one-time time option grants, such as when a new director is elected to the board for the first time. Since 2001, the median value of annual option grants has fallen by 8 percent in the S&P 500 index, risen by 26 percent in the MidCap index, and risen by 30 percent in the SmallCap index. IRRC estimates the value of an annual stock option grant by multiplying the number of underlying shares by the fiscal year-end stock price and dividing the product by three; one-time option grants are annualized over a five-year period.

**Table 3: Median annual vs. one-time option grants among indices, 2002**

Index	Annual option grant median value	One-time option grant median value (annualized)
S&P 500	\$50,667	\$23,900
MidCap	\$41,875	\$23,700
SmallCap	\$30,000	\$13,333
All study companies	\$40,467	\$18,000

The size of option grants has boomed since the mid-1990s. Since 1995, the average size of an annual option grant at an S&P 500 company rose from 357 underlying shares to 7,559 underlying shares. For the same time period and index, the average size of a one-time option grant rose from 1,364 underlying shares to 23,133 underlying shares. The size of the average option award is meaningful in that it represents the amount of cash a director stands to gain from each \$1 increase in the company's share price after the date of the option's issuance.

Premium-priced options have exercise prices above the stock's fair market value on the date of grant. Only three companies disclose granting premium-priced stock options to directors: DPL, DuPont, and Hasbro. Two companies use vesting requirements to reach a similar end. Annual options granted at USA Education and Cooper have at-the-money exercise prices, but vest upon a 20 percent increase in stock price.

### Long-term stock awards

With two exceptions, IRRC treats all equity-based awards as "long-term stock awards". The two exceptions are annual unrestricted stock awards, which are considered part of a retainer due to their high liquidity, and options to purchase stock. Only 24 percent of companies in IRRC's study issue long-term stock awards. The S&P 500 index has the highest prevalence of these awards among the indices, at 41 percent. IRRC determines the value of a stock award by multiplying the number of shares issued by the fiscal year-end stock price. As with stock options, one-time stock awards are annualized over a five-year period.

**Table 4: Average annual vs. one-time stock awards among indices, 2002**

Index	Annual stock award value	One-time stock award value (annualized)
S&P 500	\$39,463	\$16,461
MidCap	\$27,280	\$16,973
SmallCap	\$26,340	\$7,795
All study companies	\$34,669	\$14,903

### Stock ownership guidelines

Stock ownership guidelines establish an expectation for a certain level of equity interest within a prescribed timeline (for directors, usually within three to five years of joining the board). Guidelines are gaining prevalence, but remain more common for executives than for non-employee directors. As of 2002, 11 percent of all companies in IRRC's study had guidelines in place for directors. In 1996, only 6 percent were found to have such guidelines.

### Performance-based pay

Of all companies in the study, IRRC tracked only 33 companies, representing 3 percent of all study companies, tying director compensation to performance criteria. For example, ADC Telecommunications grants its annual stock option to directors only if return on equity for the previous fiscal year exceeded 10 percent.

### Total remuneration

Using data regarding board retainers, board meeting fees, committee meeting fees and retainers, option grants, and long term stock awards, IRRC estimated the "typical" director's annual compensation for each study company. The estimation was based on the assumption of perfect meeting attendance and membership on two key committees. After taking these data into account, IRRC determined that on average, two-thirds of a director compensation package derives from equity-based pay (which includes any type of stock or stock options). Please note that the formula does not take into account same-day meeting policies, low attendance policies, or any of the benefits listed below.

**Table 5: Average and median total estimated remuneration of typical director, 2002**

Index	Average total remuneration	Median total remuneration
S&P 500	\$144,459	\$113,667
MidCap	\$100,996	\$79,700
SmallCap	\$76,075	\$59,833

Index	Average total remuneration	Median total remuneration
All study companies	\$106,584	\$84,800

## Benefits

**Retirement Plans:** In 1995, 61 percent of the S&P 500 companies had an active retirement plan in place; this percentage has dropped to 5 percent for both the S&P 500 and all study companies.

**Insurance:** In 1995, 21 percent of S&P 500 companies provided insurance for directors. The prevalence has since fallen to 15 percent for the S&P 500 and 10 percent for all study companies.

**Special per-diems:** The percentage of S&P 500 companies offering special fees for services rendered outside the normal duties of board membership rose from 6 percent in 1995 to 8 percent in 2002. The prevalence is only 5 percent for all study companies.

**Charitable award programs:** The percentage of S&P 500 companies offering a **CAP**, through which a charity receive a donation funded upon the death of a director, fell to 9 percent in 2002. Twelve percent had such a program in 1998.

**Matching gifts:** The percentage of companies that match or partially match directors' charitable contributions has remained virtually the same among S&P 500 companies since 1998. The prevalence rose by one percent since last year to 6 percent.

## Disclosure

Typically, the director pay section of the proxy statement is expressed in narrative form. SEC guidelines do not address how stock option and other stock-based grants should be disclosed. As recommended by the NACD, the SEC has considered changes that would require some parts of director pay practices to be reported in tabular formats, similar to those used to report CEO pay. Some say this would increase the transparency of director pay practices and spark closer oversight by shareholders.

Currently, the SEC's Regulation S-K stipulates the following requirements under Item 402(g) for the disclosure of director pay:

- (1) Standard Arrangements. Describe any standard arrangements, stating amounts, pursuant to which directors of the registrant are compensated for any services provided as a director, including any additional amount payable for committee participation or special assignments.
- (2) Other Arrangements. Describe any other arrangement pursuant to which any director of the registrant was compensated using the registrant's last completed fiscal year of any service provided as a director, stating the amount paid and the name of the director.

Instruction to Item (2). The information required by paragraph (g)(2) of this item shall include any arrangement, including consulting contracts, entered into in consideration of the director's service on the board. The material terms of any such arrangement shall be included.

## Stock plans for directors

During 2002, IRRC tracked 356 proposals at S&P 1500 companies under which a company sought to adopt or add shares to a stock option plan that allowed non-employee directors to participate. The average opposition to such proposals was 22.1 percent, including abstentions. Plans that allow only directors to participate usually draw less shareholder opposition than those that also allow employees or executives to participate. Director plans create less potential dilution and tend to have fewer award types (e.g., restricted stock, reload options, stock appreciation rights). The appendices at the end of this report summarize the distribution, dilution, and voting opposition of such proposals since 2000.

Eight S&P 1,500 companies submitted stock plan proposals involving directors that failed to pass in 2002 (at HNC Software, Itron, Lydall, Phoenix Technologies, Progress Software, Ryan's Family Steak Houses, Therma-Wave,

and Veritas.) All of the failed plans also permitted employees to participate. In addition, all eight companies had a high overall dilution relative to their respective industry peer groups. Ryan’s Family Steak Houses later convened a special meeting at which a revised proposal passed. In 2001, six proposals were known to have failed (Citrix Systems, Coherent, Curative Health Services, Mercury Computer Systems, and two at Tetra Tech.) All of the failed plans allowed both directors and employees to participate.

## Shareholder proposals

Shareholder proposals related to director compensation generally call for one of three reforms: the adoption of stock ownership guidelines, increases in equity-based compensation, and limiting what is seen as excessive director compensation. Minimum stock ownership guidelines remain a controversial topic. Today, approximately one in every ten companies uses stock ownership guidelines for directors. Supporters point out that stock ownership guidelines are a means of fostering the alignment of directors’ interests with those of shareholders. Opponents contend that stock ownership guidelines, if too extreme, could discourage board candidates with moderate personal income, such as academics, government leaders and non-profit leaders from serving on the board.

Other shareholder proposals related to director pay are intended to voice concern that the status quo is either out of touch with shareholder interests or simply excessive. Management usually counters these proposals by saying that attractive compensation packages are necessary to attract, motivate and retain qualified directors.

Shareholder activism played a significant part in the elimination of director retirement plans and the move towards paying directors with equity-based compensation. Approximately 61 percent of S&P 500 companies reported a pension program for directors in 1995; now only 5 percent report an active retirement plan. Today, virtually all companies have incorporated some type of equity-based pay into their director compensation package. It is therefore not surprising that the number of shareholder proposals related to director pay has fallen off dramatically since the mid-1990s. IRRC tracked only three shareholder proposals related to director compensation in 2002, of which two came to a vote. The two proposals requested that “a major or full amount” of director compensation be payable in the form of common stock.

**Table 6: Shareholder proposals related to director pay in 2002**

Company	Proposal	Sponsor	Support (% of votes cast for and against)
Boeing	Pay directors in stock	Watt, D.	9.0 %
General Motors	Pay directors in stock	Chevedden Family Trust	4.9 %
PPL	Restrict director compensation	Rossnock, J.	withdrawn

IRRC tracked five shareholder proposals related to director pay in 2001; nine were tracked in 2000. By contrast, there were 99 shareholder proposals in 1996 related to director pay, of which 44 percent came to a vote. The following table illustrates the five proposals tracked from 2001.

**Table 7: Shareholder proposals related to director compensation in 2001**

Company	Shareholder proposal	Sponsor	Support (% of votes cast for and against)
AT & T	Pay directors in stock	Roberts, E.	withdrawn
CMGI	Minimum director stock ownership	Mucia, G.	n/a
General Motors	Restrict director compensation	Lauve, J.	5.6
Reynolds (R.J)	Pay directors in stock	Rossi Family	3.1
UAL	Pay directors in stock	Patterson, W.	33.7

In 2001, a proposal at General Motors requested that directors’ cash retainers be doubled to \$240,000 for any year in which the company’s market share increases. Two proposals seeking to pay directors in stock received very different levels of shareholder support despite making virtually the same request- that 100 percent of director compensation be paid in some form of stock. The stock ownership proposal at CMGI sought to require both officers and directors to own common shares valued at \$100,000 or salary plus bonus, whichever is greater.

## Looking ahead to the 2003 proxy season

IRRC is currently aware of two shareholder proposals asking to restrict director compensation for the upcoming 2003 proxy season. The proposals, submitted by Daniel Case, have been submitted to ExxonMobil and J.P. Morgan Chase, both of which are expected to hold annual meetings in late May. Subscribers are encouraged to visit IRRC's continually updated Shareholder Proposal Checklist through Online Analyst.

## Proxy voting guidelines

To ensure consistent voting practices, many institutions adopt proxy voting guidelines. While some institutions' guidelines specify how to vote in as many scenarios as possible, others simply provide a framework that is applied as proposals are reviewed on a case-by-case basis. Some institutions use a combination of both methods.

## Management proposals

Stock plans for directors usually appear in one of two varieties: either as a stand-alone plan only for directors or as a "joint" plan, which allows both directors and employees to participate. Stand-alone plans usually receive little shareholder opposition because they tend to be simpler and smaller than joint plans; stand-alone plans usually include few award types and have potential to significantly dilute equity. Joint plans also tend to offer greater flexibility in terms of when, how much, and to whom awards may be granted.

IRRC has developed triggers to alert shareholders on the key aspects of a stock plan. Voting guidelines address three elements of a compensation plan: the types of awards that may be granted, the restrictions and stipulations that apply to those awards, and the potential dilution created by the shares reserved for the awards. With the downturn of the stock market, shareholders will also incorporate the company's performance into consideration. Some critical aspects of a plan that shareholders may examine to make their voting decisions are shown below:

- **Discretionary awards:** The board may grant awards in any size it wishes to any eligible participant it wishes.
- **Omnibus plan:** The board may grant five or more different types of awards under the plan.
- **Discount option:** The board may grant stock options with exercise prices that are below the fair market value of the underlying shares on the date of grant.
- **Underwater repricing or replacing:** The board may decrease the exercise price of an outstanding option; or the board may replace an outstanding option with a new one that has a lower exercise price.
- **Accelerated vesting:** The board may accelerate the vesting schedule of an outstanding option or other award for any reason it chooses.
- **Pyramiding:** The board may allow participants to use stock that has been acquired within the previous six months upon the exercise of an option to pay for the remaining un-exercised portion of the option.
- **Change-in-control provisions:** Upon a change-in-control of the company, the board may lift all restrictions on outstanding awards, including the vesting periods of outstanding options.
- **Loans or promissory notes:** The company may issue (and in some cases may forgive) loans to cover the exercise price of an option.
- **Potential dilution of the plan:** The degree to which the shares authorized under a proposed plan could dilute currently outstanding common shares. Expressed as a percentage of outstanding common equity.
- **Potential dilution of the company's stock plans:** The degree to which newly proposed, currently available, and currently outstanding options and stock-based awards could dilute currently outstanding common shares. Expressed as a percentage of outstanding common equity.

Potential dilution may be the most heavily scrutinized element of stock plans. When options are exercised or stock is awarded, a company's voting power, assets, and earnings are spread over a larger number of shares, and each shareholder's holdings and voting rights are diluted accordingly. Some institutions require dilution to fall within the 75<sup>th</sup> percentile of a peer group's average potential dilution in order to receive a favorable vote. Others simply set a standard threshold, such as voting against any proposal that would cause the company's total potential dilution to exceed 20 percent of outstanding common stock.

Given the wide variation of shareholder proposals related to director pay, as well as their infrequency, many institutions choose to automatically review such proposals on a case-by-case basis.

## **Examples of institutional guidelines**

### **California Public Employees Retirement System**

Calpers is the largest public retirement system in the U.S., representing 1.3 million working and retired Americans. In its core principles, Calpers says, “Director compensation is a combination of cash and stock in the company. The stock component is a significant portion of the total compensation.” Calpers has disclosed the following domestic voting guidelines related to director pay:

- Stock option plans for outside directors will be approved if they appear reasonable, contain fixed issue and exercise rules, and do not represent excessive dilution. Additionally, stock options which are in lieu of/ instead of/in addition to cash compensation will be more favorably viewed.
- All proposals regarding director compensation should be examined on a case-by-case basis. Through exercising control over the income of directors and management, shareholders can ensure the accountability of those who make decisions affecting the future performance of the company.
- Stock option plans for independent directors will be approved if they appear reasonable, contain fixed issue and exercise rules and do not represent excessive dilution. Additionally, stock options, which are in lieu of/ instead of/ in addition to cash compensation, will be more favorably viewed.
- Refrain from providing pensions to non-employee directors unless approved by shareholders.
- Shareholder analysis and approval of director compensation packages is desirable. Votes will be cast in favor of these shareholder proposals.
- Retirement plans are only deemed appropriate for employees.
- Votes will be cast in favor of shareholder proposals asking companies to pay directors at least half of their annual retainer in stock rather than in cash.

Calpers’ website is [www.calpers-governance.org](http://www.calpers-governance.org)

### **Council of Institutional Investors**

CII is an organization of large public, Taft-Hartley and corporate pension funds. CII established policies that it believes should be implemented by all publicly traded companies. CII’s policies include the following:

- Absent unusual and compelling circumstances, all directors should own company common stock, in addition to any options and unvested shares granted by the company.
- Directors should be compensated only in cash or stock, with the majority of the compensation in stock.
- Pay for directors and managers should be indexed to peer or market groups, absent unusual and specified reasons for not doing so. Boards should consider options with forward contracts to align managers’ interests with shareholders’.

For additional information, visit the CII website at [www.cii.org/corp\\_governance.asp](http://www.cii.org/corp_governance.asp)

### **TIAA-CREF**

Teachers Insurance and Annuity Association-College Retirement Equities Fund provides investment and insurance services for the public as well as for the education and research community. TIAA-CREF offers a policy statement on corporate governance as a basis for dialogue with senior corporate management and boards with the objective of improving corporate governance practices. The following is taken from TIAA-CREF’s corporate governance policy statement:

- All monetary arrangements with directors for services outside normal board activities should be approved by a committee of the board that is composed of independent directors and should be reported in the proxy statement.
- The board should establish a fixed retirement policy for directors, and a requirement that all directors have a direct and material cash investment in common shares of the company. A reasonable minimum ownership interest could be defined as stock holdings equal to approximately one year’s compensation as a board member, but we recognize that what constitutes a “material” amount will necessarily vary widely from one director to another. TIAA-CREF advocates payment of directors at least partially in stock or restricted stock.

For additional information, visit the TIAA-CREF website at <http://www.tiaa-cref.org/libra/governance/>

### **Domini Social Investments**

Domini provides social-investment support services for financial professionals and institutional investors. The Domini Social Investments Proxy Voting Guidelines enumerate Domini's positions on various issues of concern. Positions related to director pay issues include:

- In general, directors should own stock in the companies on whose boards they sit. However, boards should not be restricted to those financially able to buy stock. Domini Social Investments will oppose these resolutions.
- Domini Social Investments supports reasonable compensation packages for directors. In general, Domini Social Investments does not regard as reasonable:
  1. Pension plans for outside directors (since they usually benefit from other plans).
  2. Total compensation to outside directors exceeding \$100,000 per annum.

For additional information, visit the Social Domini Investments website at [http://www.domini.com/Proxy-Voting-Guidelines/Corporate-Governance.doc\\_cvt.htm](http://www.domini.com/Proxy-Voting-Guidelines/Corporate-Governance.doc_cvt.htm)

## Appendix 1: Overview of proposals to adopt director stock option plans, 2000-2002

### Adopting a stock option plan exclusively for directors

	Number of proposals- 2002	Number of proposals- 2001	Number of proposals- 2000
S&P 1,500	38	56	43
S&P 500	16	20	17
S&P MidCap	8	13	9
S&P SmallCap	14	23	17

	Avg. dilution^ - 2002	Average voting opp.* - 2002	Avg. dilution^ - 2001	Average voting opp.* - 2001	Avg. dilution^ - 2000	Avg. voting opp.* - 2000
S&P 1,500	0.5	16.7	0.6	16.7	0.6	15.1
S&P 500	0.5	15.9	0.2	16.8	0.3	12.7
S&P MidCap	0.6	20.1	0.5	18.8	0.6	21.9
S&P SmallCap	0.6	16.8	0.9	15.4	1.0	14.7

### Adopting a stock option plan for both directors and executives/employees

	Number of proposals- 2002	Number of proposals- 2001	Number of proposals- 2000
S&P 1,500	153	120	105
S&P 500	48	43	34
S&P MidCap	39	39	25
S&P SmallCap	66	38	46

	Avg. dilution^ - 2002	Average voting opp.* - 2002	Avg. dilution^ - 2001	Average voting opp.* - 2001	Avg. dilution^ - 2000	Avg. voting opp.* - 2000
S&P 1,500	6.8	22.9	6.5	25.0	7.1	23.4
S&P 500	5.3	14.6	5.4	22.3	6.9	23.1
S&P MidCap	6.8	23.5	6.9	23.9	5.4	19.2
S&P SmallCap	8.0	25.3	7.3	29.3	8.2	26.3

\*Average voting opposition includes abstentions, which are usually counted as 'against' in stock plan proposals.

^ Note: Potential dilution data for 2000 was recorded as a percentage of voting power. Thereafter, potential dilution was recorded as a percentage of outstanding common equity.

## Appendix 2: Overview of proposals to add shares to director stock option plans, 2000-2002

### Adding shares to a stock option plan exclusively for directors

	Number of proposals- 2002	Number of proposals- 2001	Number of proposals- 2000
S&P 1,500	41	32	29
S&P 500	8	4	4
S&P MidCap	9	8	11
S&P SmallCap	24	20	14

	Avg. dilution^ - 2002	Average voing opp*- 2002	Avg. dilution^ - 2001	Avg. voting opp*- 2001	Avg. dilution- 2000	Avg. voting opp.*- 2000
S&P 1,500	0.5	22.6	0.4	17.2	0.6	17.7
S&P 500	0.2	27.8	0.3	15.4	0.2	11.7
S&P MidCap	0.4	23.8	0.2	17.2	0.4	25.0
S&P SmallCap	0.7	20.4	0.5	17.6	0.9	12.8

### Adding shares to a stock option plan for both directors and executives/employees

	Number of proposals- 2002	Number of proposals- 2001	Number of proposals- 2000
S&P 1,500	124	117	115
S&P 500	24	31	31
S&P MidCap	27	33	33
S&P SmallCap	73	53	51

	Avg. dilution^ - 2002	Average voing opp*- 2002	Avg. dilution^- 2001	Avg. voting opp*- 2001	Avg. dilution^ - 2000	Avg. voting opp.*- 2000
S&P 1,500	4.5	22.7	5.4	25.9	4.9	25.9
S&P 500	3.8	22.3	4.8	17.6	4.8	21.8
S&P MidCap	4.3	21.4	4.9	26.6	5.5	28.9
S&P SmallCap	4.9	23.4	6.2	30.3	4.7	26.7

\*Average voting opposition includes abstentions, which are usually counted as 'against' in stock plan proposals.

^ Note: Potential dilution data for 2000 was recorded as a percentage of voting power. Thereafter, potential dilution was recorded as a percentage of outstanding common equity.

### **Appendix 3: Overview of proposals to adopt or add shares to stock award plans involving directors, 2000-2002**

Year	Number of proposals	Average dilution <sup>^</sup>	Average voting opposition <sup>*</sup>
2002	11	0.3	7.9
2001	13	0.7	7.5
2000	16	0.9	8.5

\*Average voting opposition includes abstentions, which are usually counted as ‘against’ in stock plan proposals.

<sup>^</sup> Note: Potential dilution data for 2000 was recorded as a percentage of voting power. Thereafter, potential dilution was recorded as a percentage of outstanding common equity.

## Appendix 4: Shareholder proposals related to director pay, 1998-2002

### 2002

Company	Sponsor	Voting Support/Status
<b>Restrict Director Compensation</b>		
PPL	Rossnock, J.	withdrawn
<b>Pay Directors in Stock</b>		
General Motors	Chevedden Family Trust	4.9%
Boeing	Watt, D.	9.0%

### 2001

Company	Sponsor	Voting Support/Status
<b>Minimum Director Stock Ownership</b>		
CMGI	Mucia, G.	n/a
<b>Restrict Director Compensation</b>		
General Motors	Lauve, J.	5.6%
<b>Pay Directors in Stock</b>		
AT & T	Roberts, E.	withdrawn
Reynolds (R.J.)	Rossi Family	3.1%
UAL	Patterson, W.	33.7%

### 2000

Company	Sponsor	Voting Support/Status
<b>Minimum Director Stock Ownership</b>		
Morgan (J.P.)	Davis, E.	11.8%
Phillip Morris	Moloney, T.	4.7%
Merck	Moloney, T.	5.5%
<b>Restrict Director Compensation</b>		
General Motors	Lauve, J.	7.2%
<b>Pay Directors in Stock</b>		
Boeing	Coffee, J.	13.0%
PG&E	Rossi Family	13.3%
<b>Pay Directors in Cash</b>		
LTV	Weinstock	9.5%
<b>Restrict Director Pensions</b>		
General Electric	Communications Workers of America	33.8%
SBC Communications	Witsma, H.	39.2%

### 1999

Company	Sponsor	Voting Support/Status
<b>Minimum Director Stock Ownership</b>		
Bell Atlantic	Cook, W.	12.8%
Consolidated Edison	Cook, W.	omitted
International Business Machines	Cook, W.	omitted
Student Loan	DLB Fund Group	omitted
<b>Restrict Director Compensation</b>		
CVS	Teamsters	10.4%

<b>Company</b>	<b>Sponsor</b>	<b>Voting Support/Status</b>
Energy East	Rudy, E.	8.1%
Sprint	Teamsters	4.6%
<b>Pay Directors in Stock</b>		
Calmat	Steiner, W.	merger
Heilig-Meyers	Steiner, W.	withdrawn
PG&E	Rossi, N.	omitted
TransAmerica	Rossi, C.	merger
<b>Restrict Director Pensions</b>		
CINergy	International Brotherhood of Electrical Workers	withdrawn
Coca-Cola	Teamsters	withdrawn
Eastman Kodak	LongView Fund	withdrawn
General Electric	Communications Workers of America	28.8%
Lockheed Martin	Service Employees	withdrawn
SBC Communications	Witsma, H.	31.8%

## 1998

<b>Company</b>	<b>Sponsor</b>	<b>Voting Support/Status</b>
<b>Restrict Director Compensation</b>		
International Business Machines	O'Shields, H.	not in proxy
International Business Machines	Mueller, M.	omitted
New York State Electric & Gas	Rudy, E.	11.4%
<b>Pay Directors in Stock</b>		
BankAmerica	Rossi, E.	omitted
Louisiana-Pacific	Rossi, L.	13.1%
Pacific Enterprises	Rossi, C.	17.0%
PG&E	Rossi, N.	9.0%
<b>Restrict Director Pensions</b>		
Coca-Cola	Teamsters	not in proxy
General Electric	Communications Workers of America	28.6%
Lockheed Martin	Service Employees	32.5%
Nevada Power	Ayers, R.	withdrawn
New Jersey Resources	Gardell, C.	omitted
SBC Communications	Witsma, H.	31.3%
Sprint	International Brotherhood of Electrical Workers	27.9%
<b>No Director Consulting Fees</b>		
American Home Products	Operating Engineers	not presented

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