DOMESTIC VOTING POLICY STATEMENT & GUIDELINES

VERMONT STATE EMPLOYEES' RETIREMENT SYSTEM
Adopted: February 10, 2004

VERMONT STATE TEACHERS' RETIREMENT SYSTEM
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VERMONT MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM
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OFFICE OF THE VERMONT STATE TREASURER
Adopted: February 20, 2004

VERMONT PENSION INVESTMENT COMMITTEE
Amended and Adopted: February 22, 2010

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VERMONT RETIREMENT SYSTEMS
VERMONT STATE TREASURER'S OFFICE
DOMESTIC PROXY VOTING POLICY STATEMENT AND GUIDELINES

This document sets forth the proxy voting policy and guidelines of the Vermont State Treasurer's Office and Vermont's three state-sponsored defined benefit pension funds, herein referred to as "Vermont." All investment managers for Vermont, herein referred to as "managers," responsible for the voting of our owned common stock are expected to take the following proxy voting policy and guidelines into consideration before making proxy voting decisions.

We expect our investment managers to vote our proxies solely in the best interest of plan participants and beneficiaries, and Vermont citizens. Investment managers are expected to act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

The execution of proxy-voting rights at shareholder meetings is a required duty of pension fund fiduciaries. The U.S. Department of Labor (DOL) has stated that the fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock and that trustees may delegate this duty to an investment manager. [1]

Our proxy voting guidelines are designed to help ensure that Vermont fulfills its statutory and common law obligations governing proxy voting, with the intent of maximizing the long-term economic benefits of its plan participants, beneficiaries, and citizens. This includes an obligation to vote our proxies in a manner consistent with sound corporate governance and responsible corporate practices. In our view, sound corporate governance and responsible corporate practices lead to increased shareholder value.

While these guidelines often provide explicit guidance on how we would like our proxies voted on specific types of issues, investment managers are expected to analyze each question on a case-by-case basis, informed by the guidelines elaborated herein, subject to the requirement that all votes shall be cast solely in the long-term interest of the participants and beneficiaries of the plans. Each proxy issue should be subject to a rigorous analysis of the economic impact of the issue on the long-term share value.

[1] Many public sector pension plans, regulatory bodies, and professional associations have adopted the views of the U.S. Department of Labor on fiduciary duties related to proxy voting. The Department of Labor's Pension and Welfare Benefits Administration has stated in opinion letters and an interpretative bulletin that the voting rights related to shares of stock held by pension plans are plans assets. Therefore, according to the Department, "the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock." Sources include: the Department of Labor Opinion Letter (Feb.23, 1988), reprinted in 15 Pens. Rep. (BNA), 391, the Department of Labor Opinion Letter (Jan.23, 1990), reprinted in 17 Pens. Rep. (BNA), 244 and the Interpretative Bulletin, 94-2.

Vermont does not intend for these guidelines to be exhaustive. Hundreds of issues appear on proxy ballots every year, and it is neither practical nor productive to fashion voting guidelines and policies which attempt to address every eventuality. Rather, these guidelines are intended to cover the most significant and frequent proxy issues that arise. Issues not covered by the guidelines shall be voted in the interest of the participants and beneficiaries of the plan. Vermont will revise its guidelines as circumstances warrant.

These proxy voting guidelines address a broad range of issues, including the election of directors, executive compensation, proxy contests, mergers and acquisitions, and tender offer takeover defenses – voting items that can have great significance to the long-term value of pension fund assets. In addition to governance issues, these guidelines address broader issues of corporate citizenship that can also have a direct impact on corporate performance and important stakeholder interests, including the environment, job security and wage levels, local economic development and stability, and workplace safety and health issues. In accordance with state law, the policies take into consideration actions that promote good corporate citizenship through the proxy process.

Investment managers for Vermont are expected to provide quarterly vote summary reports on proxy votes cast on its behalf. These reports will be used to demonstrate consistency of manager voting with Vermont's stated policy. A copy of the *Domestic Proxy Voting Policy Statement & Guidelines* will be provided to each manager. Revised copies of this proxy voting policy statement and guidelines will be provided to managers whenever significant revisions have been made. Copies are also available online at our website: http://www.vermonttreasurer.gov/retirement.

Disclaimer: In January 2004, Vermont retained Institutional Shareholder Services Inc., now RiskMetrics Group ISS Governance Services, to develop proxy voting policies and guidelines. ISS is the world's leading provider of proxy voting, shareholder advisory services, and corporate governance research. ISS serves more than 950 institutional and corporate clients worldwide with its core business — analyzing proxies and issuing informed research and objective vote recommendations for more than 10,000 U.S. and 12,000 non-U.S. shareholder meetings each year. For more information about ISS or to download a copy of the firm's Form ADV Part II, go to www.riskmetrics.com.

BOARD OF DIRECTORS

Electing directors is the single most important stock ownership right that shareholders can exercise. By electing directors who share their views, shareholders can help to define performance standards against which management can be held accountable.

According to the *Report of the National Association of Corporate Directors' Blue Ribbon Commission on Director Professionalism (1996):* "The accepted governance paradigm is simple: management is accountable to the board and the board is accountable to shareholders… In the view of the Commission, the board does more than mechanically link those who manage the corporation and those who own it. Rather, as a surrogate for dispersed ownership, the board is at the very center of corporate governance itself."

Vermont expects managers to hold directors to a high standard when voting on their election, qualifications, and compensation. Vermont managers should evaluate directors fairly and objectively, rewarding them for significant contributions and holding them ultimately accountable to shareholders for corporate performance. Institutional investors should use their voting rights in uncontested elections to influence financial performance and corporate strategies for achieving long-term shareholder value.

Director Classification Chart

(Vermont uses the RMG director classification methodology)

1. **Inside Director (I)**
   - 1.1. Employee of the company or one of its affiliates[i].
   - 1.2. Among the five most highly paid individuals (excluding interim CEO).
   - 1.3. Listed as an officer as defined under Section 16 of the Securities and Exchange Act of 1934 ("Section 16 officer")[ii].
   - 1.4. Current interim CEO.
   - 1.5. Beneficial owner of more than 50 percent of the company's voting power (this may be aggregated if voting power is distributed among more than one member of a defined group).

2. **Affiliated Outside Director (AO)**

   Board Attestation
   - 2.1. Board attestation that an outside director is not independent.

   Former CEO
   - 2.2. Former CEO of the company[iii,iv].
   - 2.3. Former CEO of an acquired company within the past five years[iv].
   - 2.4. Former interim CEO if the service was longer than 18 months. If the service was between twelve and eighteen months an assessment of the interim CEO's employment agreement will be made[v].

   Non-CEO Executives
   - 2.5. Former Section 16 officer[ii] of the company, an affiliate[i] or an acquired firm within the past five years.
   - 2.6. Section 16 officer[ii] of a former parent or predecessor firm at the time the company was sold or split off from the parent/predecessor within the past five years.
   - 2.7. Section 16 officer[ii], former Section 16 officer, or general or limited partner of a joint venture or partnership with the company.

   Family Members
   - 2.8. Immediate family member[vi] of a current or former Section 16 officer[ii] of the company or its affiliates[i] within the last five years.
   - 2.9. Immediate family member[vi] of a current employee of company or its affiliates[i] where additional factors raise concern (which may include, but are not limited to, the following: a director related to numerous

employees; the company or its affiliates employ relatives of numerous board members; or a non-Section 16 officer in a key strategic role).

Transactional, Professional, Financial, and Charitable Relationships

2.10. Currently provides (or an immediate family member[vi] provides) professional services[vii] to the company, to an affiliate[i] of the company or an individual officer of the company or one of its affiliates in excess of $10,000 per year.

2.11. Is (or an immediate family member[vi] is) a partner in, or a controlling shareholder or an employee of, an organization which provides professional services[vii] to the company, to an affiliate[i] of the company, or an individual officer of the company or one of its affiliates in excess of $10,000 per year.

2.12. Has (or an immediate family member[vi] has) any material transactional relationship[viii] with the company or its affiliates[i] (excluding investments in the company through a private placement).

2.13. Is (or an immediate family member[vi] is) a partner in, or a controlling shareholder or an executive officer of, an organization which has any material transactional relationship[viii] with the company or its affiliates[i] (excluding investments in the company through a private placement).

2.14. Is (or an immediate family member[vi] is) a trustee, director, or employee of a charitable or non-profit organization that receives material grants or endowments[viii] from the company or its affiliates[i].

Other Relationships

2.15. Party to a voting agreement[ix] to vote in line with management on proposals being brought to shareholder vote.

2.16. Has (or an immediate family member[vi] has) an interlocking relationship as defined by the SEC involving members of the board of directors or its Compensation Committee[x].

2.17. Founder[xi] of the company but not currently an employee.

2.18. Any material[xii] relationship with the company.

3. **Independent Outside Director (IO)**

3.1. No material[xii] connection to the company other than a board seat.

Footnotes:

[i] "Affiliate" includes a subsidiary, sibling company, or parent company. RMG uses 50 percent control ownership by the parent company as the standard for applying its affiliate designation.

[ii] "Section 16 officer" (officers subject to Section 16 of the Securities and Exchange Act of 1934) includes the chief executive, operating, financial, legal, technology, and accounting officers of a company (including the president, treasurer, secretary, controller, or any vice president in charge of a principal business unit, division, or policy function). A non-employee director serving as an officer due to statutory requirements (e.g. corporate secretary) will be classified as an Affiliated Outsider. If the company provides explicit disclosure that the director is not receiving additional compensation in excess of $10,000 per year for serving in that capacity, then the director will be classified as an Independent Outsider.

[iii] Includes any former CEO of the company prior to the company's initial public offering (IPO).

[iv] When there is a former CEO of a special purpose acquisition company (SPAC) serving on the board of an acquired company, RMG will generally classify such directors as independent unless determined otherwise taking into account the following factors: the applicable listing standards determination of such director's independence; any operating ties to the firm; and the existence of any other conflicting relationships or related party transactions.

[v] RMG will look at the terms of the interim CEO's employment contract to determine if it contains severance pay, long-term health and pension benefits, or other such standard provisions typically contained in contracts of permanent, non-temporary CEOs. RMG will also consider if a formal search process was underway for a full-time CEO at the time.

[vi] "Immediate family member" follows the SEC's definition of such and covers spouses, parents, children, step-parents, step-children, siblings, in-laws, and any person (other than a tenant or employee) sharing the household of any director, nominee for director, executive officer, or significant shareholder of the company.

[vii] Professional services can be characterized as advisory in nature, generally involve access to sensitive company information or to strategic decision-making, and typically have a commission- or fee-based payment structure. Professional services generally include, but are not limited to the following: investment banking/financial advisory services; commercial banking (beyond deposit services); investment services; insurance services; accounting/audit services; consulting services; marketing services; legal services; property management services; realtor services; lobbying services; executive search services; and IT consulting services. The following would

generally be considered transactional relationships and not professional services: deposit services; IT tech support services; educational services; and construction services. The case of participation in a banking syndicate by a non-lead bank should be considered a transactional (and hence subject to the associated materiality test) rather than a professional relationship. "Of Counsel" relationships are only considered immaterial if the individual does not receive any form of compensation (in excess of $10,000 per year) from, or is a retired partner of, the firm providing the professional service. The case of a company providing a professional service to one of its directors or to an entity with which one of its directors is affiliated, will be considered a transactional rather than a professional relationship. Insurance services and marketing services are assumed to be professional services unless the company explains why such services are not advisory.

[viii] A material transactional relationship, including grants to non-profit organizations, exists if the company makes annual payments to, or receives annual payments from, another entity exceeding the greater of $200,000 or 5 percent of the recipient's gross revenues, in the case of a company which follows NASDAQ listing standards; or the greater of $1,000,000 or 2 percent of the recipient's gross revenues, in the case of a company which follows NYSE/Amex listing standards. In the case of a company which follows neither of the preceding standards, RMG will apply the NASDAQ-based materiality test. (The recipient is the party receiving the financial proceeds from the transaction).

[ix] Dissident directors who are parties to a voting agreement pursuant to a settlement arrangement, will generally be classified as independent unless determined otherwise taking into account the following factors: the terms of the agreement; the duration of the standstill provision in the agreement; the limitations and requirements of actions that are agreed upon; if the dissident director nominee(s) is subject to the standstill; and if there any conflicting relationships or related party transactions.

[x] Interlocks include: executive officers serving as directors on each other's compensation or similar committees (or, in the absence of such a committee, on the board); or executive officers sitting on each other's boards and at least one serves on the other's compensation or similar committees (or, in the absence of such a committee, on the board).

[xi] The operating involvement of the founder with the company will be considered. Little to no operating involvement may cause RMG to deem the founder as an independent outsider.

[xii] For purposes of RMG's director independence classification, "material" will be defined as a standard of relationship (financial, personal or otherwise) that a reasonable person might conclude could potentially influence one's objectivity in the boardroom in a manner that would have a meaningful impact on an individual's ability to satisfy requisite fiduciary standards on behalf of shareholders.

Voting on Director Nominees in Uncontested Elections

Votes concerning the entire board of directors and members of key board committees should be examined using the following five factors:

- Lack of independence of the full board and key board committees (fully independent audit, compensation, and nominating committees);
- Diversity of board;
- Performance of the board and key board committees (flagrant actions by management or the board, excessive risk-taking, problematic governance provisions, egregious compensation practices, poor accounting practices, imprudent use of corporate assets, etc.);
- Failure of the board to properly respond to majority votes on shareholder proposals;
- Poor long-term corporate performance record relative to peer index and S&P 500 when necessary and in exceptional or tie-breaking circumstances.

Votes on individual director nominees should always be made on a CASE-BY-CASE basis. Specific withhold votes from individual director nominees may be triggered by one or more of the following factors:

• Lack of a board that is at least majority independent – i.e., where the composition of non-independent board members is in excess of 50 percent of the entire board;
• Attendance of director nominees at board meetings of less than 75 percent in one year without valid reason or explanation;
• Lack of independence on key board committees (i.e., audit, compensation, and nominating committees);
• Failure to establish any key board committees (i.e., audit, compensation, or nominating);
• Directors serving on an excessive number of other boards which could compromise their primary duties of care and loyalty;
• Chapter 7 bankruptcy, SEC violations, and criminal investigations by the Department of Justice (DOJ) and/or other federal agencies;
• Interlocking directorships;
• Performance of compensation committee members related to the approval of egregious executive compensation (both cash and equity awards);
• Performance of audit committee members concerning the approval of excessive non-audit fees and/or the lack of auditor ratification upon the proxy ballot.
• If at the previous board election, any director received more than 50 percent withhold/against votes of the shares cast and the company has failed to address the underlying issue(s) that caused the high withhold/against vote;

• The board failed to act on takeover offers where the majority of the shareholders tendered their shares;

• The board lacks accountability and oversight, coupled with sustained poor performance relative to peers;

• If the company has a classified board and a continuing director is responsible for a problematic governance issue at the board/committee level that would warrant a withhold/against vote, in addition to potential future withhold/against votes on that director, Vermont may vote against or withhold votes from any or all of the nominees up for election, with the exception of new nominees;

• The presence of problematic governance or management issues (including flagrant actions by management or the board with potential or realized negative impacts on shareholders, interlocking directorships, multiple related-party transactions or other issues putting director independence at risk, problematic corporate governance provisions, or corporate scandals).

Vermont manager should vote AGAINST or WITHHOLD votes from the members of the Audit Committee when:

• Consulting (i.e. non-audit) fees paid to the auditor are excessive;

• Auditor ratification is not included on the proxy ballot;

• The company receives an adverse opinion on the company's financial statements from its auditor;

• There is evidence that the audit committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the audit firm; or

• Poor accounting practices such as: fraud; misapplication of GAAP; and material weaknesses identified in Section 404 disclosures, exist. Poor accounting practices may warrant voting against or withholding votes from the full board.

Vermont managers should vote AGAINST or WITHHOLD votes from the members of the Compensation Committee when:

• There is a negative correlation or disconnect between the CEO's pay and company performance;

• The company implements a repricing or an option exchange program, by buying out underwater options for stock, cash or other consideration or canceling underwater options and regranting options with a lower exercise price, without prior shareholder approval, even if such repricings are allowed in its equity plans;

• The company fails to submit one-time transfers of stock options to a shareholder vote;

• The company fails to fulfill the terms of a burn rate commitment they made to shareholders;

• The company has backdated options (see Options Backdating policy);

• There is evidence that management/board members are using company stock in hedging activities

• The company has poor compensation practices such as the provision of excise tax gross-ups, single and modified single trigger provisions, liberal change in control definitions, excessive executive perks and tax gross-ups on executive perks, excessive executive pay or disproportionately high compensation payouts tied to short-term financial results, etc. (see Poor Pay Practices policy). Poor pay practices may warrant voting against or withholding votes from the entire board.

Voting for Director Nominees in Contested Elections

Contested elections of directors frequently occur when a board candidate or "dissident slate" seeks election for the purpose of achieving a significant change in corporate policy or control of seats on the board. Competing slates should be evaluated on a CASE-BY-CASE basis with a number of considerations in mind. These include, but are not limited to, the following: personal qualifications of each candidate; the economic impact of the policies advanced by the dissident slate of nominees; and their expressed and demonstrated commitment to the interests of the shareholders of the company.

Votes in a contested election of directors should be evaluated on a CASE-BY-CASE basis, with the following seven factors in consideration:

• Long-term financial performance of the target company relative to its industry in exceptional or tie-breaking circumstances;
• Management's historical track record;
• Background to the proxy contest;
• Qualifications of director nominees (both slates);
• Strategic plan of dissident slate and quality of critique against management;
• Evaluation of what each side is offering shareholders as well as the likelihood that the proposed objectives and goals in these proposals are realistic, achievable, demonstrable, and viable under the current conditions by which the company operates;
• Equity ownership positions;
• Total impact on all stakeholders.

On occasion, Vermont may provide specific voting instructions to its managers pertaining to high profile proxy contests, "vote no" initiatives, or contested transactions. In these select instances, managers of the funds will be expected to execute Vermont voting instructions in good faith.

Non-Independent Chairman

Arguments have been made that a smaller company and its shareholders can benefit from the full-time attention of a joint chairman/CEO. This may be so in select cases, and indeed, using a case-by-case review of circumstances, there may be worthy exceptions. But even in these cases, it is our general view that a person should serve in the position of joint CEO and chairman only on a temporary basis. Once a company reaches a point of maturity, these positions should be separated. Clearly, the prevalence of joint CEO/Chairman positions in boardrooms has stretched well beyond the small-cap universe of companies. Today, roughly two-thirds of companies in both the S&P 500 and Russell 3000 fall into this category.

We strongly believe that the potential for conflicts of interest in the board's supervisory and oversight duties trumps any possible corollary benefits that could ensue from a dual CEO/chairman scenario. Instead of having an ingrained *quid pro quo* situation whereby a company has a single leader overseeing both management and the boardroom, we believe that it is the board's implicit duty to assume an impartial and objective role in overseeing the executive team's overall performance. Shareholder interests are placed in jeopardy if the CEO of a company is required to report to a board that she/he also chairs. Inherent in the chairman's job description is the duty to assess the CEO's performance. This objectivity is obviously compromised when a chairman is in charge of evaluating her/his own performance. Moreover, the unification of chairman and CEO poses a direct threat to the smooth functioning of the entire board process since it is the ultimate responsibility of the chairman to set the agenda, facilitate discussion, and make sure that directors are given complete access to information in order to make informed decisions.

Two major components at the top of every public company are the running of the board and the executive responsibility for the running of the company's business. Without doubt, there should be a clear division of responsibilities at the head of the company that will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. When there is no clear division between the executive and board branches of a company, poor executive and/or board actions often go unchecked to the ultimate detriment of shareholders. Since executive compensation is so heavily correlated to the managerial power relationship in the boardroom, the separation of the CEO and chairman positions is a critical step in curtailing excessive pay, which ultimately can become a drain on shareholder value. Indeed, a number of academic studies have demonstrated that executive compensation is 20 to 40 percent higher if the CEO is also the chairman of the board.

Vermont managers should:

- Generally vote AGAINST or WITHHOLD votes from any non-independent director who serves as board chairman;
- Generally WITHHOLD votes from a CEO who is also serving in the role of chairman at the same company;
- Generally support shareholder proposals calling for the separation of the CEO and chairman positions; and
- Generally support shareholder proposals calling for a non-executive director to serve as chairman who is not a former CEO or senior-level executive of the company.

Independent Directors

Vermont believes that a board independent from management is of vital importance to a company and its shareholders. Accordingly, Vermont expects votes to be cast in a manner that shall encourage the independence of boards. Independence will be evaluated based upon a number of factors, including: employment by the company or an affiliate in an executive capacity; past or current employment by a firm that is one of the company's paid advisors or consultants; personal services contract with the company; family relationships of an executive or director of the company; interlocks where two CEOs/Chairmen serve on each others' boards; instances where directors serve on more than one board (and key committees) together; and service with a non-profit that receives significant contributions from the company.

Vermont managers should:

- Generally WITHHOLD votes from non-independent board members (insiders and affiliated outsiders) where the board is not at least a majority (50+ percent) independent;
- Generally consider independent board members who have been on the board continually for a period longer than 10 years as affiliated outsiders;
- Vote FOR shareholder proposals requesting that all key board committees (i.e., audit, compensation, and/or nominating) include independent directors exclusively;
- Vote FOR shareholder proposals requesting that the board be comprised of a majority of independent directors.

Excessive Directorships

Recent regulations have been mandated that directors be more engaged in protecting shareholder interests or else risk civil and/or criminal sanctions. As such, board members must devote more time and effort to their oversight duties which, on average, were estimated to run to 300 hours per year per board for 2003. Recent surveys of directors also confirm a desire for limiting board memberships, generally to three-to-five seats. In view of the increased demands placed on board members, Vermont believes that directors who are overextended may be jeopardizing their ability to serve as effective representatives of shareholders. We expect votes to be withheld from directors serving on an excessive number of other boards, which could compromise their primary duties of care and loyalty.

Vermont managers should:

• Generally WITHHOLD votes from directors serving on an excessive number of boards. As a general rule, vote AGAINST or WITHHOLD from director nominees who are:

- CEOs of publicly traded companies who serve on more than two public boards (i.e. more than one public boards other than their own board). NOTE: Vermont will vote against or withhold from overboarded CEO directors only at their outside directorships and not at the company in which they presently serve as CEO)
- Non-CEO directors who serve on more than six public company boards.

Performance/Governance Evaluation for Directors

Many institutional investors believe long-term financial performance and the appropriateness of governance practices should be taken into consideration when determining vote recommendations with regard to directors in uncontested elections. When evaluating whether to vote against or withhold votes from director nominees, we will evaluate underperforming companies that exhibit sustained poor performance as measured by one- and three-year total shareholder returns in the bottom half of a company's four-digit GICS industry group (Russell 3000 companies only). For companies outside the Russell 3000 universe, a company will be considered to have exhibited sustained poor performance if it underperforms its peers or index on the basis of both one-year and three-year total shareholder returns.

Vermont views deficient oversight mechanisms and the lack of board accountability to shareholders especially in the context of sustained poor performance, as problematic. As part of our framework for assessing director performance, we will also evaluate board accountability and oversight at companies that demonstrate sustained underperformance. A governance structure that discourages director accountability may lead to board and management entrenchment. For example, the existence of several anti-takeover provisions* has the cumulative effect of deterring legitimate tender offers, mergers, and corporate transactions that may have ultimately proved beneficial to shareholders. When a company maintains entrenchment devices, shareholders of poorly performing companies are left with few effective routes to beneficial change.

Vermont will assess the company's response to the ongoing performance issues, and consider recent board and management changes, board independence, overall governance practices, and other factors that may have an impact on shareholders. If a company exhibits sustained poor performance coupled with a lack of board accountability and oversight, we may also consider the company's five-year total shareholder return and five-year operational metrics in our evaluation.

*Problematic provisions include but are not limited to:

- a classified board structure;
- a supermajority vote requirement;
- majority voting with no carve out for contested elections;
- the inability for shareholders to call special meetings;
- the inability for shareholders to act by written consent;
- a dual-class structure; and/or
- a non-shareholder approved poison pill.

Vermont manager should vote AGAINST/WITHHOLD votes from all director nominees if the board lacks accountability and oversight, coupled with sustained poor performance relative to peers. Sustained poor performance is measured by one- and three-year total shareholder returns in the bottom half of a company's four-digit GICS industry group (Russell 3000 companies only). Sustained poor performance for companies outside the Russell 3000 universe, is defined as underperforming peers or index on the basis of both one-year and three-year total shareholder returns.

Director Diversity

We support gender and ethnic diversity as an important component of a company's board. Diversity brings different perspectives to a board that in turn lead to a more varied approach to board issues. We believe that increasing diversity in the boardroom to better reflect a company's workforce, customers, and community enhances shareholder value.

Vermont managers should:

• Support proposals asking the board to make greater efforts to search for qualified female and minority candidates for nomination to the board of directors;
• Support endorsement of a policy of board inclusiveness; and
• Support reporting to shareholders on a company's efforts to increase diversity and stakeholder participation on their boards.

Stock Ownership Requirements

Corporate directors should own some amount of stock of the companies on which they serve as board members. Stock ownership is a simple method to align the interests of directors with company shareholders. Nevertheless, many highly qualified individuals such as academics and clergy who can offer valuable perspectives in board rooms may be unable to purchase individual shares of stock. In such a circumstance, the preferred solution is to look at the board nominees individually and take stock ownership into consideration when voting on the merits of each candidate.

Vermont managers should:

• Vote AGAINST shareholder proposals requiring directors to own a minimum amount of company stock in order to qualify as a director nominee or to remain on the board.

Classified Boards / Annual Elections

The ability to elect directors is the single most important use of the shareholder franchise, and all directors should be accountable on an annual basis. Annually elected boards provide the best governance system for accountability to shareholders. A classified board is a board that is divided into separate classes, with directors serving overlapping terms. A company with a classified board usually divides the board into three classes. Under this system, only one class of nominees comes up to shareholder vote at the AGM each year.

As a consequence of these staggered terms, shareholders only have the opportunity to vote on a single director approximately once every three years. A classified board makes it difficult to change control of the board through a proxy contest, since it would normally take two years to gain control of a majority of board seats. Under a classified board, the possibility of management entrenchment greatly increases. Classified boards can reduce director accountability by shielding directors, at least for a certain period of time, from the consequences of their actions. Continuing directors who are responsible for a problematic governance issue at the board/committee level would avoid shareholders' reactions to their actions because they would not be up for election in that year. Ultimately, in these cases, the full board should be responsible for the actions of its directors.

Many in management believe that staggered boards provide continuity. Some shareholders believe that in certain cases a staggered board can provide consistency and continuity in regard to decision-making and commitment that may be important to the long-term financial future of the company.

Nevertheless, empirical evidence suggests that staggered boards may not in all cases be in the shareholders' best interests. A classified board can entrench management and effectively preclude most takeover bids or proxy contests.

Vermont managers should:

• Vote AGAINST management or shareholder proposals seeking to classify the board when the issue comes up for vote;

• Vote FOR management or shareholder proposals to repeal a company's classified board structure.

• If the company has a classified board and a continuing director is responsible for a problematic governance issue at the board/committee level that would warrant a withhold/against vote, in addition to potential future withhold/against votes on that director, we may vote against or withhold votes from any or all of the nominees up for election, with the exception of new nominees.

Board and Committee Size

While there is no hard and fast rule among institutional investors as to what may be an optimal size board, Vermont believes there is an acceptable range which companies should strive to meet and not exceed. A board that is too large may function inefficiently. Conversely, a board that is too small may allow the CEO to exert disproportionate influence or may stretch the time requirements of individual directors too thin.

Vermont expects proposals seeking to set board size to be evaluated on a CASE-BY-CASE basis. Given that the preponderance of boards in the U.S. range between five and 15 directors, we believe this is a useful benchmark for evaluating such proposals.

Vermont managers should:

• Generally vote AGAINST any proposal seeking to amend the company's board size to fewer than five seats;
• Generally vote AGAINST any proposal seeking to amend the company's board size to more than 15 seats; and
• Evaluate board size on a CASE-BY-CASE basis and consider WITHHOLDS or other action at companies that have fewer than five directors and more than 15 directors on their board.

Limit Term of Office

Those who support term limits argue that this requirement would bring new ideas and approaches on to a board. Here again we prefer to look at directors as individuals rather than impose a strict rule. While term of office limitations can rid the board of non-performing directors over time, it can also unfairly force experienced and effective directors off the board.

Vermont managers should:

• Generally vote AGAINST shareholder proposals to limit the tenure of outside directors.

Cumulative Voting

Most corporations provide that shareholders are entitled to cast one vote for each share owned. Under a cumulative voting scheme, the shareholder is permitted to have one vote per share for each director to be elected. Shareholders are permitted to apportion those votes in any manner they wish among the director candidates. Shareholders have the opportunity to elect a minority representative to a board through cumulative voting, thereby ensuring representation for all sizes of shareholders.

For example, if there is a company with a ten-member board and 500 shares outstanding—the total number of votes that may be cast is 5,000. In this case, a shareholder with 51 shares (10.2 percent of the outstanding shares) would be guaranteed one board seat because all votes may be cast for one candidate. Without cumulative voting, anyone controlling 51 percent of shares would control the election of all ten directors.

With the advent and prevalence of majority voting for director elections, shareholders now have greater flexibility in supporting candidates for a company's board of directors. Cumulative voting and majority voting are two different voting mechanisms designed to achieve two different outcomes. While cumulative voting promotes the interests of minority shareholders by allowing them to get some representation on the board, majority voting promotes a democratic election of directors for all shareholders and ensures board accountability in uncontested elections. Though different in philosophic view, cumulative voting and majority voting can work together operationally, with companies electing to use majority voting for uncontested elections and cumulative voting for contested elections to increase accountability and ensure minority representation on the board.

In contested elections, similar to cumulative voting, proxy access allows shareholder access to the ballot without a veto from the nominating committee, but unlike cumulative voting, it also requires majority support to elect such directors.

At controlled companies, where majority insider control would preclude minority shareholders from having any representation on the board, cumulative voting would allow such representation and shareholder proposals for cumulative voting would be supported.

Vermont managers should:

- Vote AGAINST proposals to eliminate cumulative voting; and
- Vote FOR proposals to permit cumulative voting unless:
    - The company has proxy access or a similar structure[2] to allow shareholders to nominate directors to the company's ballot; and
    - The company has adopted a majority vote standard, with a carve-out for plurality voting in situations where there are more nominees than seats, and a director resignation policy to address failed elections.
- Vote FOR proposals for cumulative voting at controlled companies (where insider voting power exceeds 50 percent).

Failure to Act on Shareholder Proposals Receiving Majority Support

- Vermont managers should generally vote AGAINST or WITHHOLD from all director nominees at a company that has ignored a shareholder proposal that was approved by a majority of the votes cast at the last annual meeting.

[2] A similar structure would be a structure that allows shareholders to nominate candidates who the company will include on the management ballot in addition to management's nominees, and their bios are included in management's proxy.

Votes Against or Withholds from Directors for Shareholder Rights Plan (i.e., Poison Pills)

Shareholders should have the ability to vote on any shareholder rights plan adopted by a board as to ensure that the features of the poison pill support the interests of shareholders and do not merely serve as a management entrenchment device. If the board, in the exercise of its fiduciary duties, determines that a pill is in the best interests of shareholders and adopts it without shareholder approval, the pill would still require a shareholder vote within twelve months after adoption. A pill adopted under this "fiduciary out" exception should expire or be ratified by shareholder vote within twelve months after adoption.

Vermont managers should:

- Vote AGAINST or WITHHOLD votes from director nominees at a company that has a dead-hand or modified dead-hand poison pill in place;
- Vote AGAINST or WITHHOLD votes from directors if the board has adopted or renewed a poison pill without shareholder approval since the company's last annual meeting and there is no requirement to put the pill to shareholder vote within twelve months of adoption (or in the case of an newly public company, does not commit to put the pill to a shareholder vote within 12 months following the IPO), or if the board reneges on a commitment to put the pill to a vote.

Shareholder Access to the Proxy ("Open Access")

The current director election process as it exists leaves much to be desired. Companies currently nominate for election only one candidate for each board seat. Shareholders who oppose a candidate have no easy way to do so unless they are willing to undertake the considerable expense of running an independent candidate for the board. The only way for shareholders to register symbolic dissent about a certain director candidate is to simply "withhold" support from that nominee. But because directors are typically elected by a plurality (those nominees receiving the most votes win board seats), company nominees running unopposed are reelected.

- Vermont managers will consider on a CASE-BY-CASE basis reasonably crafted shareholder proposals asking companies to voluntarily provide shareholders the ability to nominate director candidates to be included on management's proxy card, taking into account the ownership threshold proposed in the resolution. Special consideration will be made at companies where there are legitimate concerns surrounding responsiveness to shareholders (such as not implementing majority-supported shareholder proposals), board and key committee independence, problematic governance and compensation practices, and past accounting or financial issues such as restatements.

Majority Threshold Voting Requirement for Director Elections

Shareholders have expressed strong support for precatory resolutions on majority threshold voting since 2005, with a number of proposals receiving majority support from shareholders. We believe shareholders should have a greater voice in regard to the election of directors and view majority threshold voting as a viable alternative to the current deficiencies of the plurality system in the U.S.

Vermont managers should

- Generally support reasonably crafted shareholders proposals calling for directors to be elected with an affirmative majority of votes cast and/or the elimination of the plurality standard for electing directors (including binding resolutions requesting that the board amend the company's bylaws), provided the proposal includes a carve-out for a plurality voting standard when there are more director nominees than board seats (e.g. in contested elections).

- Vermont may recommend withhold/against votes on members of the board at companies without the carve-out for plurality voting in contested elections, as the use of a majority vote standard can act as an anti-takeover defense in contested elections. (e.g. although the dissident nominees may have received more shares cast, as long as the combination of withhold/against votes and the votes for the management nominees keep the dissident nominees under 50 percent, the management nominees will win, due to the holdover rules). This is clearly contradicts the expressed will of shareholders.

- In addition to supporting proposals seeking a majority vote standard in director elections, we also support a post-election "director resignation policy" that addresses the situation of holdover directors to accommodate both shareholder proposals and the need for stability and continuity of the board.

Establish an Office of the Board

- Vermont managers should generally vote FOR shareholders proposals requesting that the board establish an *Office of the Board of Directors* in order to facilitate direct communication between shareholders and non-management directors, unless the company has effectively demonstrated via public disclosure that it already has an established structure in place.

Director and Officer Indemnification and Liability Protection

Management proposals typically seek shareholder approval to adopt an amendment to the company's charter to eliminate or limit the personal liability of directors to the company and its shareholders for monetary damages for any breach of fiduciary duty to the fullest extent permitted by state law. In contrast, shareholder proposals seek to provide for personal monetary liability for fiduciary breaches arising from gross negligence. While Vermont recognizes that a company may have a more difficult time attracting and retaining directors if they are subject to personal monetary liability, Vermont believes the great responsibility and authority of directors justifies holding them accountable for their actions.

Each proposal addressing director liability should be evaluated consistent with this philosophy. Vermont managers may support these proposals when the company persuasively argues that such action is necessary to attract and retain directors, but Vermont managers may often oppose management proposals and support shareholder proposals in light of our philosophy of promoting director accountability.

Vermont managers should:

• Vote AGAINST proposals to limit or eliminate entirely director and officer liability in regards to: (i) breach of the director's fiduciary "duty of loyalty" to shareholders; (ii) acts or omissions not made in "good faith" or involving intentional misconduct or knowledge of violations under the law; (iii) acts involving the unlawful purchases or redemptions of stock; (iv) payment of unlawful dividends; or (v) use of the position as director for receipt of improper personal benefits.

Indemnification

Indemnification is the payment by a company of the expenses of directors who become involved in litigation as a result of their service to a company. Proposals to indemnify a company's directors differ from those to eliminate or reduce their liability because with indemnification directors may still be liable for an act or omission, but the company will bear the expense. Vermont managers may support these proposals when the company persuasively argues that such action is necessary to attract and retain directors, but should generally oppose indemnification when it is being proposed to insulate directors from actions they have already taken.

Vermont managers should:

• Vote AGAINST indemnification proposals that would expand individual coverage beyond ordinary legal expenses to also cover specific acts of negligence which exceed the standard of mere carelessness that is regularly covered in board fiduciary indemnification; and
• Vote FOR only those proposals which provide expanded coverage in cases when a director's or officer's legal defense was unsuccessful if: (1) the director was found to have acted in good faith and in a manner that he/she reasonably believed was in the best interests of the company; and (2) only if the director's legal expenses would be covered.

Poison Pills

Shareholder rights plans, typically known as poison pills, take the form of rights or warrants issued to shareholders and are triggered when a potential acquiring stockholder reaches a certain threshold of ownership. When triggered, poison pills generally allow shareholders to purchase shares from, or sell shares back to, the target company ("flip-in pill") and/or the potential acquirer ("flip-out pill") at a price far out of line with fair market value.

The most lethal variation of the poison pill is a "dead-hand" pill. The dead-hand pill is an especially noxious anti-takeover device designed to prevent the acquisition of a company even if a majority of shareholders favor the acquisition. What makes dead-hands so problematic is that they can only be removed by incumbent directors or chosen successors. The Delaware Chancery Court ruled in 1998 that dead-hand shareholder rights plans violate Delaware law. In striking down the dead-hand pill, the court declared that it lacked statutory authority under Delaware General Corporation law because it "limited in a substantial way the freedom of [newly elected] directors' decisions on matters of management policy and violated the duty of each [newly elected] director to exercise his own best judgment on matters coming before the board."[3]

Depending on the type of pill, the triggering event can either transfer wealth from the target company or dilute the equity holdings of current shareholders. Poison pills insulate management from the threat of a change in control and provide the target board with veto power over takeover bids. Because poison pills greatly alter the balance of power between shareholders and management, shareholders should be allowed to make their own evaluation of such plans.

Vermont managers should:

• Vote FOR shareholder proposals that ask a company to submit its poison pill for shareholder ratification;
• Review CASE-BY-CASE shareholder proposals to redeem a company's poison pill;
• Review CASE-BY-CASE management proposals to ratify a poison pill;
• Vote AGAINST or WITHHOLD from any board where a dead-hand poison pill provision is in place. From a shareholder perspective, there is no justification for a dead-hand provision. Directors of companies with these lethal protective devices should be held accountable.

Net operating losses (NOL) pills, which are used to preserve a tax benefit (as opposed to traditional poison pills which are used as a takeover defense), typically have low triggers that some shareholders have difficulty supporting. This lack of support may have the effect of discouraging issuers from seeking shareholder approval for such pills. In assessing NOL pills, we take into account the unique purpose and features of NOL pills to enable shareholders make

[3] 721 A.2d 1281 (Del. 1998)

informed decisions when presented with proposals to adopt such pills, and to encourage issuers to submit such pills to a shareholder vote.
For management proposals to adopt a poison pill for the stated purpose of preserving a company's net operating losses ("NOL pills"), the following factors are considered:

- the trigger (NOL pills generally have a trigger slightly below 5 percent);
- the value of the NOLs;
- the term;
- shareholder protection mechanisms (sunset provision, causing expiration of the pill upon exhaustion or expiration of NOLs); and
- other factors as applicable.

Greenmail

Greenmail payments are targeted share repurchases by management of company stock from individuals or groups seeking control of the company. Since only the hostile party receives payment, usually at a substantial premium over the market value of shares, the practice discriminates against most shareholders. This transferred cash, absent the greenmail payment, could be put to much better use for reinvestment in the company, payment of dividends, or to fund a public share repurchase program.

Vermont managers should:

• Vote FOR proposals to adopt an anti-greenmail provision in their charter or bylaws that would thereby restrict a company's ability to make greenmail payments to certain shareholders; and
• Review on a CASE-BY-CASE basis all anti-greenmail proposals when they are presented as bundled items with other charter or bylaw amendments.

Shareholder Ability to Remove Directors

Shareholder ability to remove directors, with or without cause, is either prescribed by a state's business corporation law, individual company's articles of incorporation, or its corporate bylaws. Many companies have sought shareholder approval for charter or bylaw amendments that would prohibit the removal of directors except for cause, thus ensuring that directors would retain their directorship for their full-term unless found guilty of self-dealing. By requiring cause to be demonstrated through due process, management insulates the directors from removal even if a director has been performing poorly, not attending meetings, or not acting in the best interests of shareholders.

Vermont managers should:

• Vote AGAINST proposals that provide that directors may be removed only for cause;
• Vote FOR proposals that seek to restore the authority of shareholders to remove directors with or without cause;
• Vote AGAINST proposals that provide only continuing directors may elect replacements to fill

board vacancies; and
• Vote FOR proposals that permit shareholders to elect directors to fill board vacancies.

Shareholder Ability to Alter the Size of the Board

Proposals that would allow management to increase or decrease the size of the board at its own discretion are often used by companies as a takeover defense. Vermont supports management proposals to fix the size of the board at a specific number, thus preventing management -- when facing a proxy context -- from increasing the board size without shareholder approval. By increasing the size of the board, management can make it more difficult for dissidents to gain control of the board. Fixing the size of the board also prevents a reduction in the size of the board as a strategy to oust independent directors. Fixing board size also prevents management from increasing the number of directors in order to dilute the effects of cumulative voting.

Vermont managers should:

• Vote FOR proposals that seek to fix the size of the board within an acceptable range; and
• Vote AGAINST proposals that give management the ability to alter the size of the board without shareholder approval.

AUDITORS

Auditors play an integral role in certifying the integrity and reliability of corporate financial statements on which investors rely to gauge the financial well being of a company. The recent auditor-facilitated debacles at Enron, WorldCom, and Tyco underscore the catastrophic consequences that investors can suffer when the audit process breaks down.

The wave of recent accounting scandals at these companies illuminates the need to ensure auditor independence in the face of selling consulting services to audit clients. At the Big Five (now Final Four) accounting firms revenues from non-audit services grew from 13 percent of total revenues in 1981 to half of total revenue in 2000. A recent study of over 1,200 US companies in the S&P 500, Mid Cap, and Small Cap indices found that 72 percent of fees paid to auditors in 2002 were for non-audit services, exactly the same level as 2001. We believe that the ratio should be reversed, and that non-audit fees should make up no more than one-quarter of all fees paid to the auditor so as to properly discourage even the appearance of any undue influence upon an auditor's objectivity.

Under SEC rules, disclosed categories of professional fees paid for audit and non-audit services are as follows: (1) Audit Fees, (2) Audit-Related Fees, (3) Tax Fees, and (4) All Other Fees. Under the revised reporting requirements, a company will also be required to describe – in qualitative terms – the types of services provided under the three categories other than Audit Fees. The following fee categories are defined as: A) tax compliance or preparation fees are excluded from our calculations of non-audit fees; and B) fees for consulting services for tax-avoidance strategies and tax shelters will be included in "other fees" and will be considered non-audit fees if the proxy disclosure does not indicate the nature of the tax services. In circumstances where "Other" fees include fees related to significant one-time capital structure events: initial public offerings, bankruptcy emergence, and spin-offs; and the company makes public disclosure of the amount and nature of those fees which are an exception to the standard "non-audit fee" category, then such fees may be excluded from the non-audit fees considered in determining the ratio of non-audit to audit/audit-related fees/tax compliance and preparation for purposes of determining whether non-audit fees are excessive.

As auditors are the backbone upon which a company's financial health is measured, auditor independence is absolutely essential for rendering objective opinions upon which investors then rely. When an auditor is paid excessive consulting fees in addition to fees paid for auditing, the company-auditor relationship is left open to conflicts of interest.

Auditor Ratification

The ratification of auditors is an important component of good governance. In light of the Sarbanes-Oxley Act and increased shareholder scrutiny, some companies are opting to take auditor ratification off the ballot. Neglecting to include the ratification of auditors on the proxy statement removes the fundamental shareholder right to ratify the company's choice of auditor. Whereas two years ago shareholder ratification of auditors might have been considered routine by many shareowners, the subsequent accounting scandals have caused shareholders to be more vigilant about the integrity of the auditors certifying their companies' financial statements.

Although US companies are not legally required to allow shareholders to ratify their appointment of independent auditors, roughly 60 percent of S&P 500 companies allow for shareholder ratification of their auditors. Submission of the audit firm for approval at the annual meeting on an annual basis gives shareholders the means to weigh in on their satisfaction (or lack thereof) on the audit firm's independent execution of its duties. We firmly believe mandatory auditor ratification is in line with sound and transparent corporate governance and remains an important mechanism to ensure the integrity of the auditor's work. In the absence of legislation mandating shareholder ratification of auditors, the failure by a company to present its selection of auditors for shareholder ratification should be discouraged, as it undermines good governance and disenfranchises shareholders.

Because accounting scandals evaporate shareholder value, any proposal to ratify auditors should be examined for potential conflicts of interest, with particular attention to the fees paid to the auditor, as well as whether the ratification of auditors has been put up for shareholder vote.

Vermont managers should:

• Vote FOR proposals to ratify auditors when the amount of audit fees is equal to or greater than three times (75 percent) the amount paid for consulting, unless: i) An auditor has a financial interest in or association with the company, and is therefore not independent; or ii) There is reason to believe that the independent auditor has rendered an opinion which is neither accurate nor indicative of the company's financial position;
• Vote AGAINST proposals to ratify auditors when the amount of non-audit consulting fees exceeds a quarter of all fees paid to the auditor;
• WITHHOLD votes from Audit Committee members in cases where consulting fees exceed audit fees; and
• WITHHOLD votes from Audit Committee members when auditor ratification is not included on the proxy ballot.
• Generally support shareholder proposals seeking to limit companies from buying consulting services from their auditor.

Auditor Rotation

Long-term relationships between auditors and their clients can impede auditor independence, objectivity, and professional skepticism. Such long-standing relationships foster an undesirable coziness between audit firms and their clients, which can cause the auditors to lose their independence and become less questioning especially where lucrative contracts for the provision of non-audit consulting services are involved. Mandatory auditor rotation is a widely supported safeguard against improper audits and is viewed by many as an effective mechanism for mitigating the potential risks borne by long-term auditor-client relationships. Proponents of compulsory audit firm rotation contend that rotation policies promote objectivity and independence among auditors and minimize the scope of vested interests developing in the audit.

Opponents of audit firm rotation argue that regular re-tendering is costly, likely to reduce audit quality, and increase the risk of audit failure in the early years due to the time required to gain cumulative knowledge of an often complex and geographically diverse business. A solution around this apparent negative effect of mandatory rotation is to keep a longer rotation period.

In general, Vermont believes that companies should not maintain the same audit firm in excess of seven years, and will consider voting against auditors if their tenure at a company exceeds seven years. A revolving seven-year rotation period allows the auditor to develop cumulative knowledge of a company's business and the effect of changes in the business along with the corresponding changes in its risks, thereby enhancing the quality of the audit and trammeling potential loss of auditor objectivity and independence. We consider the increased costs associated with compulsory auditor rotation to be a lesser evil vis-à-vis the larger evil of the costs to shareholders when the objectionable coziness between clients and long-standing auditors leads to gross erosion of shareholder value.

Vermont managers should:

• Generally support shareholder proposals to ensure auditor independence through measures such as mandatory auditor rotation (no less than every seven years); and

Auditor Indemnification and Limitation of Liability

Indemnification clauses allow auditors to avoid liability for potential damages, including punitive damages. Eliminating concerns about being sued for carelessness could lead to; 1) potential impairment of external auditor independence and impartiality by contractual clauses limiting their liability; and 2) a decrease the quality and reliability of the audit given the lack of consequence for an inadequate audit.

Given the substantial settlements against auditors in recent years for poor audit practices and the cost of such insurance to the company and its shareholders, there are legitimate concerns over the broader use of indemnification clauses. Such agreements may weaken the objectivity, impartiality and performance of audit firms. Vermont believes it is important for shareholders to understand the full risks and implications of these agreements and determine what impact they could have on shareholder value. At the present time, however, due to poor disclosure in this area, it is difficult to identify the existence and extent of limited liability provisions and auditor agreements, and investors lack the information needed to make informed decisions regarding these agreements.

Without uniform disclosure, it is difficult to consistently apply policy and make informed vote recommendations. As such, Vermont reviews the use of indemnification clauses and limited liability provisions in auditor agreements on a case-by-case basis, when disclosure is present.

• Vermont managers should vote AGAINST or WITHHOLD from Audit Committee members if there is persuasive evidence that the audit committee entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the audit firm.

Disclosures Under Section 404 of Sarbanes-Oxley Act

Section 404 of the Sarbanes-Oxley Act requires that companies document and assess the effectiveness of their internal financial controls. Beginning in 2005, most public companies must obtain annual attestation of the effectiveness of their internal controls over financial reporting from their outside auditors. Companies with significant material weaknesses identified in the Section 404 disclosures potentially have ineffective internal financial reporting controls, which may lead to inaccurate financial statements, hampering shareholders' ability to make informed investment decisions, and may lead to destruction of public confidence and shareholder value. The Audit Committee is ultimately responsible for the integrity and reliability of the company's financial information and its system of internal controls.

Vermont managers should:

• Vote AGAINST or WITHHOLD votes from Audit Committee members under certain circumstances when a material weakness rises to a level of serious concern, if there are chronic internal control issues, or if there is an absence of established effective control mechanisms;

• Vote AGAINST management proposals to ratify auditors if there is reason to believe that the independent auditor has rendered an opinion which is neither accurate nor indicative of the company's financial position**;**

Adverse Opinions

An Adverse Opinion on the company's financial statements is issued when the auditor determines that the financial statements are materially misstated and, when considered as a whole, do not conform to GAAP. It essentially states that the information contained is materially incorrect, unreliable, and inaccurate in order to assess the company's financial position and results of operations.

Adverse opinions on companies' financial statements are generally very rare because they essentially state that a significant portion of the financial statements are unreliable and the auditor had no choice but to issue an adverse opinion after a long process of seeking resolution with the company subjected to the audit.

• Vermont managers should vote AGAINST or WITHHOLD votes from Audit Committee members if the company receives an Adverse Opinion on the company's financial statements from its auditors.

MERGERS & ACQUISITIONS

In analyzing M&A deals, private placements or other transactional related items on proxy, Vermont performs a well-rounded analysis that seeks to balance all facets of the deal to ascertain whether the proposed acquisition is truly going to generate long-term value for shareholders and enhance the prospects of the ongoing corporation.

Votes on mergers and acquisitions should be considered on a CASE-BY-CASE basis, taking into account at least the following:

- Impact of the merger on shareholder value;
- Perspective of ownership (target vs. acquirer) in the deal;
- Form and mix of payment (i.e. stock, cash, debt, etc.);
- Fundamental value drivers behind the deal;
- Anticipated financial and operating benefits realizable through combined synergies;
- Offer price (cost vs. premium);
- Change-in-control payments to executive officers;
- Financial viability of the combined companies as a single entity;
- Was the deal put together in good faith? What kind of auction setting took place? Were negotiations carried out at arm's length? Was any portion of the process tainted by possible conflicts of interest?;
- Fairness opinion (or lack thereof);
- Changes in corporate governance and their impact on shareholder rights;
- What are the potential legal or environmental liability risks associated with the target firm?;
- Impact on community stakeholders and employees in both workforces;
- How will the merger adversely affect employee benefits like pensions and health care?

Fair Price Provisions

Fair price provisions were originally designed to specifically defend against the most coercive of takeover devises— the two-tiered, front-end-loaded tender offer. In such a hostile takeover, the bidder offers cash for enough shares to gain control of the target. At the same time, the acquirer states that once control has been obtained, the target's remaining shares will be purchased with cash, cash, and securities, or only securities. Since the payment offered for the remaining stock is, by design, less valuable than the original offer for the controlling shares, shareholders are forced to sell out early to maximize the value of their shares. Standard fair price provisions require that— absent board or shareholder approval of the acquisition— the bidder must pay the remaining shareholders the same price for their shares as for those that brought control.

Vermont managers should:

• Vote FOR fair price proposals as long as the shareholder vote requirement embedded in the provision is no more than a majority of disinterested shares; and
• Vote FOR shareholder proposals to lower the shareholder vote requirement in existing fair price provisions.

Corporate Restructuring

Votes concerning corporate restructuring proposals, including minority squeezeouts, leveraged buyouts, spin-offs, liquidations, and asset sales should be considered on a CASE-BY-CASE basis.

Appraisal Rights

Rights of appraisal provide shareholders who do not approve of the terms of certain corporate transactions the right to demand a judicial review in order to determine the fair value for their shares. The right of appraisal applies to mergers, sale of corporate assets, and charter amendments that may have a materially adverse effect on the rights of dissenting shareholders.

Vermont managers should:

• Vote FOR proposals to restore or provide shareholders with the right of appraisal.

Spin-offs

Votes on spin-offs should be considered on a CASE-BY-CASE basis depending on the tax and regulatory advantages, planned use of sale proceeds, market focus, and managerial incentives.

Asset Sales

Votes on asset sales should be made on a CASE-BY-CASE basis after considering the impact on the balance sheet/working capital, value received for the asset, and potential elimination of diseconomies.

Liquidations

Votes on liquidations should be made on a CASE-BY-CASE basis after reviewing management's efforts to pursue other alternatives, appraisal value of assets, and the compensation plan for executives managing the liquidation.

Going Private Transactions (LBOs, Minority Squeezeouts)

Vermont managers should:
• Vote on a CASE-BY-CASE basis on going private transactions, taking into account the following: offer price/premium, fairness opinion, how the deal was negotiated, conflicts of interest, other alternatives/offers considered, and non-completion risk.

• Vote CASE-BY-CASE on “going dark” transactions, determining whether the transaction enhances shareholder value by taking into consideration whether the company has attained benefits from being publicly-traded (examination of trading volume, liquidity, and market research of the stock), cash-out value, whether the interests of continuing and cashed-out shareholders are balanced, and market reaction to public announcement of transaction.

Changing Corporate Name

Vermont managers should vote FOR changing the corporate name in all instances if proposed and supported by management.

SHAREHOLDER RIGHTS

Confidential Voting

The confidential ballot ensures that voters are not subject to real or perceived coercion. In an open voting system, management can determine who has voted against its nominees or proposals before a final vote count. As a result, shareholders can be pressured to vote with management at companies with which they maintain or would like to establish a business relationship.

Vermont managers should:

- Vote FOR shareholder proposals that request corporations to adopt confidential voting, use independent tabulators, and use independent inspectors of election as long as the proposals include clauses for proxy contests as follows: in the case of a contested election, management is permitted to request that the dissident group honor its confidential voting policy. If the dissidents agree, the policy remains in place. If the dissidents do not agree, the confidential voting policy is waived; and
- Vote FOR management proposals to adopt confidential voting procedures.

Shareholder Ability to Call Special Meetings

Most state corporation statutes allow shareholders to call a special meeting when they want to take action on certain matters that arise between regularly scheduled annual meetings. Sometimes this right applies only if a shareholder or a group of shareholders own a specified percentage of shares, with ten percent being the most common. Shareholders may lose the ability to remove directors, initiate a shareholder resolution, or respond to a beneficial offer without having to wait for the next scheduled meeting if they are unable to act at a special meeting of their own calling.

Vermont managers should:

- Vote AGAINST proposals to restrict or prohibit shareholder ability to call special meetings; and
- Vote FOR proposals that remove restrictions on the right of shareholders to act independently of management.
- Vote AGAINST provisions that would require advance notice of more than sixty days.

Shareholder Ability to Act by Written Consent

Consent solicitations allow shareholders to vote on and respond to shareholder and management proposals by mail without having to act at a physical meeting. A consent card is sent by mail for shareholder approval and only requires a signature for action. Some corporate bylaws require supermajority votes for consents, while at others standard annual meeting rules apply. Shareholders may lose the ability to remove directors, initiate a shareholder resolution, or respond to a beneficial offer without having to wait for the next scheduled meeting if they are unable to act at a special meeting of their own calling.

Vermont managers should:

• Vote AGAINST proposals to restrict or prohibit shareholder ability to take action by written consent; and
• Vote FOR proposals to allow or make easier shareholder action by written consent.

Equal Access

Directors on a number of corporate boards have rewarded undeserving corporate executives with excessive compensation and retirement perks. Moreover, in too many situations stolid directors have remained uninformed or unwilling to challenge management with the tough questions their fiduciary duties and obligations require by law. Hard-learned lessons from recent corporate scandals have demonstrated that passive board behavior can lead to the deterioration of shareholder wealth, jobs, and local communities.

The current "take-it-or-leave-it" director election process as it exists leaves much to be desired. Companies currently nominate for election only one candidate for each board seat. Shareholders who oppose a candidate have no easy way to do so unless they are willing to undertake the considerable expense of running an independent candidate for the board. The only way for shareholders to register dissent about a given director candidate is to withhold support from that nominee.

On October 8, 2003, the SEC proposed historic corporate accountability proxy rules (proposal S7-19-03) that would give significant long-term shareholders greater ability to include their director nominees in management's proxy statement. By giving shareholders a voice in picking corporate directors, the reforms put forward by the SEC have the potential to put an end to the CEO cult and give shareholders far greater say in choosing the directors most able to represent their interests.

The SEC proposal entails a two-step, two-year process. In the first year (2004), one of two triggering events must occur: (1) One or more directors at a company receive withhold votes of 35 percent or more of the votes cast; or (2) A shareholder proposal asking for open access, which is submitted by holders of at least one percent of the shares (owned for at least one year), is approved by a majority of the votes cast.

If one of these conditions is met, then for the following two years (2005 and 2006), the company would be required to include in its proxy materials one or more board nominees (depending on the board size) proposed by holders of at least five percent of the shares (owned for at least two years).

Vermont espouses ballot access mechanisms for shareholders and supports well-targeted proxy-access proposals at companies where there are legitimate concerns surrounding responsiveness to shareholders (such as not implementing majority-supported shareholder proposals), board and key committee independence, compensation practices, and accounting and financial issues (such as restatements).

Vermont managers should:

• Vote FOR shareholder resolutions filed by one-percent, one-year shareholders that, if passed, will be binding on the company per the proposed SEC trigger; and
• Review CASE-BY-CASE predatory shareholder proposals asking companies to voluntarily adopt open access, perhaps at a different trigger than the SEC's proposed five-percent, two-year ownership threshold.

Unequal Voting Rights

Incumbent managers are able to use unequal voting rights through the creation of a separate class of shares which have superior voting rights to the common shares of regular shareholders. This separate class of shares with disproportionate voting power allows management to concentrate its power and insulate itself from the wishes of the majority of shareholders. Dual class exchange offers involve a transfer of voting rights from one group of shareholders to another group of shareholders typically through the payment of a preferential dividend. A dual class recapitalization plan also establishes two classes of common stock with unequal voting rights, but initially involves an equal distribution of preferential and inferior voting shares to current shareholders.

Vermont managers should:

• Vote FOR resolutions that seek to maintain or convert to a one share, one vote capital structure; and
• Vote AGAINST requests for the creation or continuation of dual class capital structures or the creation of new or additional super-voting shares.

Supermajority Shareholder Vote Requirement to Amend the Charter or Bylaws

Supermajority shareholder vote requirements for charter or bylaw amendments are often the result of "lock-in" votes, which are the votes required to repeal new provisions to the corporate charter. Supermajority provisions violate the principle that a simple majority of voting shares should be all that is necessary to effect change regarding a company and its corporate governance provisions. Requiring more than this may entrench managers by blocking actions that are in the best interests of shareholders.

Vermont managers should:

• Vote AGAINST management proposals to require a supermajority shareholder vote to approve charter and bylaw amendments;
• Vote AGAINST management proposals seeking to lower supermajority shareholder vote requirements when they accompany management-sponsored proposals to also change certain charter or bylaw amendments; and
• Vote FOR shareholder proposals to lower supermajority shareholder vote requirements for charter and bylaw amendments.

Supermajority Shareholder Vote Requirement to Approve Mergers

Supermajority provisions violate the principle that a simple majority of voting shares should be all that is necessary to effect change regarding a company and its corporate governance provisions. Requiring more than this may entrench managers by blocking actions that are in the best interests of shareholders.

Vermont managers should:

• Vote AGAINST management proposals to require a supermajority shareholder vote to approve mergers and other significant business combinations; and
• Vote FOR shareholder proposals to lower supermajority shareholder vote requirements for mergers and other significant business combinations.

Reimburse Proxy Solicitation Expenses

Vermont generally supports shareholder proposals to reimburse for proxy solicitation expenses;

• When voting in conjunction with support of a dissident slate, always support the reimbursement of all appropriate proxy solicitation expenses associated with the election;

• Generally support requests seeking to reimburse a shareholder proponent for all reasonable campaign expenditures for a proposal approved by the majority of shareholders.

Bundled Proposals

• Vermont managers will vote CASE-BY-CASE on bundled or conditional proxy proposals. In the case of items that are conditioned upon each other, examine the benefits and costs of the packaged items. In instances when the joint effect of the conditioned items is not in shareholders' best interests, vote AGAINST the proposals. If the combined effect is positive, support such proposals.

CAPITAL STRUCTURE

The management of a corporation's capital structure involves a number of important issues including dividend policy, types of assets, opportunities for growth, ability to finance new projects internally, and the cost of obtaining additional capital. Many financing decisions have a significant impact on shareholder value, particularly when they involve the issuance of additional common stock, preferred stock, or debt.

Common Stock Authorization

State statutes and stock exchanges require shareholder approval for increases in the number of common shares. Corporations increase their supply of common stock for a variety of ordinary business purposes: raising new capital, funding stock compensation programs, business acquisitions, implementation of stock splits, or payment of stock dividends.

Vermont supports management proposals requesting shareholder approval to increase authorized common stock when management provides persuasive justification for the increase. For example, Vermont would support increases in authorized common stock to fund stock splits that are in shareholders' interests. Vermont managers should evaluate proposals on a CASE-BY-CASE basis when the company intends to use the additional stock to implement a poison pill or other takeover defense. Vermont managers should evaluate the amount of additional stock requested in comparison to the requests of the company's peers, as well as the company's articulated reason for the increase.

Vermont managers should:

• Review on a CASE-BY-CASE basis proposals to increase the number of shares of common stock authorized for issue. The following factors will be considered: rationale for the increase, the board's governance structure and practices, existing takeover defenses, the absence of egregious equity compensation practices, and risks to shareholders of not approving the request;; and
• Vote AGAINST proposals at companies with dual-class capital structures to increase the number of authorized shares of the class of stock that has superior voting rights
• Generally vote AGAINST proposed common stock authorizations that increase the existing authorization by more than fifty percent unless a clear need for the excess shares is presented by the company.

Reverse Stock Splits

Reverse splits exchange multiple shares for a lesser amount to increase share price. Increasing share price is sometimes necessary to restore a company's share price to a level that will allow it to be traded on the national stock exchanges. In addition, some brokerage houses have a policy of not monitoring or investing in very low priced shares. Reverse stock splits can help maintain stock liquidity.

Vermont managers should review management proposals to implement a reverse stock split on a CASE-BY-CASE basis, taking into account whether there is a corresponding proportional decrease in authorized shares. Managers should generally support a reverse stock split if management provides a reasonable justification for the split and reduces authorized shares accordingly. Without a corresponding decrease, a reverse stock split is effectively an increase in authorized shares by reducing the number of shares outstanding while leaving the number of authorized shares to be issued at the pre-split level.

Blank Check Preferred Stock Authorization

Preferred stock is an equity security which has certain features similar to debt instruments— such as fixed dividend payments and seniority of claims to common stock— and usually carries little to no voting rights. The terms of blank check preferred stock give the board of directors the power to issue shares of preferred stock at their discretion with voting, conversion, distribution, and other rights to be determined by the board at time of issue. Blank check preferred stock can be used for sound corporate purposes, but can also be used as a device to thwart hostile takeovers without shareholder approval.

Vermont managers should:

• Vote FOR proposals to create blank check preferred stock in cases when the company expressly states that the stock will not be used as a takeover defense or carry superior voting rights;
• Review on a CASE-BY-CASE basis proposals that would authorize the creation of new classes of preferred stock with unspecified voting, conversion, dividend, distribution, and other rights;
• Review on a CASE-BY-CASE basis proposals to increase the number of authorized blank check preferred shares. If the company does not have any preferred shares outstanding, we will vote AGAINST the requested increase;
• Vote FOR shareholder proposals to have blank check preferred stock placements, other than those shares issued for the purpose of raising capital or making acquisitions in the normal course of business, submitted for shareholder ratification.
• Vote FOR proposals to eliminate dual class common stock.

Adjust Par Value of Common Stock

Stock that has a fixed per share value that on its certificate is called par value stock. The purpose of par value stock is to establish the maximum responsibility of a stockholder in the event that a corporation becomes insolvent. Proposals to reduce par value come from certain state level requirements for regulatory industries, such as banks, and other legal requirements relating to the payment of dividends.

Vermont managers should:

• Vote FOR management proposals to reduce the par value of common stock.

Preemptive Rights

Preemptive rights permit shareholders to share proportionately in any new issues of stock of the same class. These rights guarantee existing shareholders the first opportunity to purchase shares of new issues of stock in the same class as their own and in the same proportion. The absence of these rights could cause stockholders' interest in a company to be reduced by the sale of additional shares without their knowledge and at prices unfavorable to them. Preemptive rights, however, can make it difficult for corporations to issue large blocks of stock for general corporate purposes. Both corporations and shareholders benefit when corporations are able to arrange issues without preemptive rights that do not result in a substantial transfer of control.

Vermont managers should:

• Review on a CASE-BY-CASE basis proposals to create or abolish preemptive rights. In evaluating proposals on preemptive rights, managers should look at the size of a company and the characteristics of its shareholder base.

Debt Restructuring

Vermont managers should review on a CASE-BY-CASE basis proposals to increase common and/or preferred shares and to issue shares as part of a debt restructuring plan.

Vermont managers should carefully consider the following issues:

• *Dilution*: How much will ownership interests of existing shareholders be reduced and how extreme will dilution to any future earnings be?
• *Change in Control*: Will the transaction result in a change in control of the company?
• *Bankruptcy*: How real is the threat of bankruptcy? Is bankruptcy the main factor driving the debt restructuring? Would the restructuring result in severe loss to shareholder value?
• *Possible self-dealings*: Generally approve proposals that facilitate debt restructuring unless there are clear signs of self-dealing or other abuses.

Share Repurchase Programs

The use of stock buyback programs increased greatly during the 1980s. The total proportion of total cash payout (dividends and repurchases) to shareholders from stock repurchases rose from 25 percent during 1983-1986 to 34 percent during 1987-1988. Stock repurchases serve two main purposes which benefit shareholders. First, they serve as a more efficient vehicle for distributing cash to shareholders than paying dividends. Second, announcements of stock repurchase programs tend to result in increased returns to shareholders. One study found that such programs result in a two-percent excess return to shareholders. Some argue that the reason for this phenomenon is that managers either believe their company's stock is undervalued or that management is acting on positive inside information. In addition, buybacks result in fewer shares on the open market, which causes an increase in price due to an improved supply-demand position.

A potential negative attribute of share repurchase programs is that they can be used to increase management's holdings in a given company and make a takeover more difficult to achieve. However, shareholders may find that the premium from a large buyback is enough to compensate for any adverse consequences from its antitakeover effect. Shareholders should also be wary of share repurchase programs that allow executives of the company to purchase shares with a small down payment and take a low-interest (or no-interest) loan from the company for the remainder of the cost. Another downside of a share repurchase is that it may signal to the market that a company does not have more attractive alternatives for long-term capital investment such as acquisitions or equipment purchases.

Although used less frequently, shareholders may also encounter "Dutch auctions." This novel buyback technique consists of an offer to shareholders by the company to repurchase a limited number of shares at a range of premium market prices. In essence, shareholders get to choose their premium. The catch is that when the company counts up all the offers tendered by shareholders, it will compute the lowest average price that will permit it to repurchase the number of desired shares. The company then fills the orders of the lowest bids until the share repurchase objective is achieved. Shareholders who bid too high are left out in the cold. However, all shareholders benefit to some extent whether or not they tender because the auction will generally move the stock price higher. Shareholders do not have to approve a Dutch auction; they merely decide whether or not to tender and at what price.

Vermont managers should vote FOR management proposals to institute open-market share repurchase plans in which all shareholders may participate on equal terms.

COMPENSATION

Vermont believes that executive pay programs should be fair, competitive, reasonable, and appropriate, and that pay for performance should be a central tenet in executive compensation philosophy. Examples of best pay practices include:

Employment contracts: Companies should enter into employment contracts under limited circumstances for a short time period (e.g., new executive hires for a three-year contract) for limited executives. The contracts should not have automatic renewal feature and should have a specified termination date.

Severance agreements: Severance provisions should not be so appealing that they become an incentive for the executive to be terminated. The severance formula should be reasonable and not overly generous to the executive (e.g., use maximum severance multiple of 3X pay; use pro-rated target/average historical bonus and not maximum bonus). Failure to renew employment contract, termination under questionable events or for poor performance should not constitute "good reason" for termination with severance payments.

Change-in-control payments: Change-in-control payments should be "double-triggered" – i.e. payouts should only made when there is a significant change in company ownership structure, and when there is a loss of employment or substantial change in job duties associated with the change in company ownership structure. Change-in-control provisions should exclude excise tax gross-ups and should not authorize the acceleration of vesting of equity awards upon a change in control unless provided under a double-trigger scenario. Similarly, change in control provisions in equity plans should be double-triggered. A change in control event should not result in an acceleration of vesting of all unvested stock options or lapsing of vesting/performance requirements on restricted stock/performance shares, unless there is a loss of employment or substantial change in job duties.

Supplemental executive retirement plans (SERPs): SERPs should not include sweeteners that can increase the payout value significantly or even exponentially, such as additional years of service credited for pension calculations, or inclusion of variable pay (e.g. bonuses and equity awards) into the formula. Pension formulas should not include extraordinary annual bonuses paid close to the time of retirement and should be based on an average, not the maximum, level of compensation earned.

Deferred compensation: Above-market returns or guaranteed minimum returns should not be applied on deferred compensation.

Disclosure practices: The Compensation, Discussion and Analysis should be written in plain English, with as little "legalese" as possible and formatted using section headers, bulleted lists, tables and charts where possible to ease reader comprehension. Ultimately, the document should provide detail and rationale regarding compensation, strategy, pay mix, goals/metrics, challenges, competition and pay for performance linkage, etc. in a narrative fashion.

Responsible use of company stock: Companies should adopt policies that prohibit executives from speculating in company's stock or using company stock in hedging activities, such as "cashless" collars, forward sales, equity swaps or other similar arrangements. Such behavior undermines the ultimate alignment with long-term shareholders' interests. In addition, the policy should prohibit or discourage the use of company stock as collateral for margin loans, to avoid any potential sudden stock sales (required upon margin calls) that could have a negative impact on the company's stock price.

Long-term focus: Executive compensation programs should be designed to support companies' long-term strategic goals. A short-term focus on performance does not necessarily create sustainable shareholder value. Instead, long-term goals may be sacrificed to achieve short-term expectations to the detriment of shareholder value, as evidenced by the financial crisis.
Compensation programs embedding a long-term focus with respect to company goals better align with the long-term interests of shareholders. Granting stock options and restricted stock to executives that vest in five years does not necessarily provide a long-term focus, as executives can sell off the company shares once they vest. However, requiring senior executives to hold company stock until retirement or after retirement can encourage a long-term focus on company performance.

Stock Option Plans

Vermont supports compensating executives at a reasonable rate and believes that executive compensation should be strongly correlated to performance. Stock options, restricted stock, and other forms of non-cash compensation should be performance-based with an eye toward improving long-term shareholder value. Well-designed stock option plans can align the interests of executives and shareholders by providing that executives benefit when stock prices rise as the company— and shareholders— prosper together.

Many plans sponsored by management provide goals so easily attained that executives can realize massive rewards even though shareholder value is not necessarily created. Vermont supports option plans that provide legitimately challenging performance targets that serve to truly motivate executives in the pursuit of long-term performance goals. Likewise, we oppose plans that offer unreasonable benefits to executives that are not available to any other shareholders. Among other features of the plan that may not be in shareholders' best interests, Vermont managers should take into consideration the following factors before voting on related questions.

Methodology for Analyzing Equity Pay Plans

In general, managers should consider executive and director compensation plans on a CASE-BY-CASE basis. When evaluating executive and director compensation matters, please review the following elements:

<u>Primary Considerations</u>:
• *Dilution*: Vote AGAINST plans in which the potential voting power dilution (VPD) of all shares outstanding exceeds 10 percent;

• *Full Market Value*: Awards must be granted at 100 percent of fair market value on the date of grant. However, in instances when a plan is open to broad-based employee participation and excludes the five most highly compensated employees, we accept a 15 percent discount;
• *Stock Option Expensing*: Vote AGAINST plans if the company does not fully expense its stock options.

<u>Secondary Considerations</u>:
• *Burn Rate*: Vote AGAINST plans where the annual burn rate exceeds industry and index burn rates over a three-year period;
• *Pay-For-Performance Metric*: Vote AGAINST plans where CEO pay and the company's performance is incongruous, as measured against industry peers over both one and three-year periods;
• *Evergreen Features*: Vote AGAINST plans that reserve a specified percentage of outstanding shares for award each year instead of having a termination date;
• *Repricing*: Vote AGAINST plans if the company's policy permits repricing of "underwater" options or if the company has a history of repricing past options. In those instances when repricing is put up for a shareholder vote, we will vote FOR the repricing of shares under the following four conditions: 1) The repricing represents a "value for value" exchange; 2) If the five most highly compensated employees are excluded from the repricing; 3) If the plan is broad-based; and 4) If the current vesting schedule is maintained.

Dilution Calculation

Voting power dilution, or VPD, measures the amount of voting power represented by the number of shares reserved over the life of the plan. Industry norms dictate that ten percent dilution over the life of a ten-year plan is reasonable for most mature companies. Restricted stock plans or stock bonus plans which stand alone and are not coupled with stock option plans can be held to a lower dilution cap.

Voting power dilution may be calculated using the following formula:
A = Shares reserved for this amendment or plan;
B = Shares available under this plan and/or continuing plans prior to proposed amendment;
C = Shares granted but unexercised under this plan and/or continuing plans;
D = All outstanding shares plus any convertible equity, outstanding warrants, or debt.

The formula can be applied as follows:

$$\frac{A + B + C}{A + B + C + D}$$

Fair Market Value, Dilution, and Repricing

Vermont managers should consider whether the proposed plan is being offered at fair market value or at a discount; whether the plan excessively dilutes the earnings per share of the outstanding shares; and whether the plan gives management the ability to replace or reprice "underwater" options. Repricing is an amendment to a previously granted stock option contract that reduces the option exercise price. Options are "underwater" when their current price is below the current option contract price. Options can also be repriced through cancellations and re-grants. The typical new grant would have a ten-year term, new vesting restrictions, and a lower exercise price reflecting the current lower market price.

Burn Rate

Vermont managers should examine the annual burn rate, which is a measure of dilution that illustrates how rapidly a company is deploying shares reserved for equity compensation plans. The burn (or run) rate is calculated by dividing the number of shares pursuant to awards granted in a given year by the number of shares outstanding. Managers should benchmark a company's burn rate against three-year industry and primary index burn rates, and generally oppose plans whose burn rates exceed both industry and index burn rates over a three-year period.

Executive Concentration Ratio

In examining stock option awards, restricted stock and other forms of long-term incentives, it is important to consider internal pay equity; that is, the concentration and distribution of equity awards to a company's top five executives ("named officers") as a percentage of overall grants. Vermont will consider voting against equity compensation plans whose annual grant rate to top executives exceeds one percent of shares outstanding.

Principle of Pay-for-Performance

Vermont acknowledges that stock-based pay is often the main driver for excessive executive compensation, which is fueled by poor administration of the plan. High levels of compensation are tangled up with corporate shenanigans and illegal activity as evidenced in Tyco, Enron, and WorldCom. Managers should, therefore, closely examine any discrepancies between increases in CEO pay and total shareholder returns against those of peer firms over a one- and three-year time frame in assessing equity-based compensation plans.

We believe significant disparities between pay and performance warrant withholding votes from Compensation Committee members who are responsible for overseeing the company's compensation schemes. If the equity component is the source of the imbalance, Vermont managers should oppose the equity plan in which the CEO participates.

Evergreen Provisions

Vermont also opposes plans that reserve a specified percentage of outstanding shares for award each year (evergreen plans) instead of having a termination date. Such plans provide for an automatic increase in the shares available for grant with or without limits on an annual basis. Because they represent a transfer of shareholder value and have a dilutive impact on a regular basis, evergreen plans are expensive to shareholders. Evergreen features also minimize the frequency that companies seek shareholder approval in increasing the number of shares available under the plan.

Restricted Stock

Vermont supports the use of performance-vesting restricted stock so long as the absolute amount of restricted stock being granted is a reasonable proportion of an executive's overall compensation. The best way to align the interests of executives with shareholders is through direct stock holdings, coupled with at-risk variable compensation that is tied to explicit and challenging performance benchmarks. Performance-vesting restricted stock both adds to executives direct share holdings and incorporates at-risk features.

To reward performance and not job tenure, restricted stock vesting requirements should be performance-based rather than time-lapsing. Such plans should explicitly define the performance criteria for awards to senior executives and may include a variety of corporate performance measures in addition to the use of stock price targets. In addition, executives should be required to hold their vested restricted stock as long as they remain employees of the company.

Option Exchange Programs/Repricing Options

Vermont managers will vote CASE-BY-CASE on management proposals seeking approval to exchange/reprice options taking into consideration the following factors:
Historic trading patterns: the stock price should not be so volatile that the options are likely to be back "in-the-money" over the near term;

• Rationale for the repricing: was the stock price decline beyond management's control?

• Option vesting: does the new option vest immediately or is there a black-out period?

• Term of the option: the term should remain the same as that of the replaced option;

• Exercise price: should be set at fair market or a premium to market;

• Participants: the plan should be broad-based and executive officers and directors should be excluded;

• Is this a value-for-value exchange?

• Are surrendered stock options added back to the plan reserve?

If the surrendered options are added back to the equity plans for re-issuance, then we will also take into consideration the impact on the company's equity plans and its three-year average burn rate.

In addition to the above considerations, we will evaluate the intent, rationale, and timing of the repricing proposal. The proposal should clearly articulate why the board is choosing to conduct an exchange program at this point in time. Repricing underwater options after a recent precipitous drop in the company's stock price demonstrates poor timing. We do not view market deterioration, in and of itself, as an acceptable reason for companies to reprice stock options and/or reset goals under performance plans. Repricing after a recent decline in stock price triggers additional scrutiny and may warrant a vote AGAINST the proposal. At a minimum, the decline should not have happened within the past year. Also, consider the terms of the surrendered options, such as the grant date, exercise price and vesting schedule. Grant dates of surrendered options should be far enough back (two to three years) so as not to suggest that repricings are being done to take advantage of short-term downward price movements. Similarly, the exercise price of surrendered options should be above the 52-week high for the stock price.

Vermont managers should vote FOR shareholder proposals to put option repricings to a shareholder vote.

Poor Compensation Practices and Compensation Committee Performance

Poor disclosure, the absence or non-transparency of disclosure and poor plan design of compensation payouts lead to excessive executive compensation practices that are detrimental to shareholders. Poorly designed plans or those lacking in transparency can be reflective of a poorly performing compensation committee.

Companies are expected to meet a minimum standard of tally sheet disclosure as to allow shareholders to readily assess the total executive pay package, understand the actual linkage between pay and performance, and mitigate misinformation to shareholders. The SEC issued new rules on executive and director compensation in 2006 that will require expansive disclosure and a total compensation figure for each of the named executive officers.

Executive compensation will continue to be in the spotlight in the ensuing years, particularly when shareholders will have access to more complete information. In the absence of poor disclosure that would necessitate a higher level of scrutiny, Vermont may also consider voting against or withholding from the compensation committee for failure to provide pertinent information in its committee report.

• Vermont will consider voting AGAINST or WITHHOLDING votes from compensation committee members and/or the CEO on a CASE-BY-CASE basis if the company has poor compensation practices. In addition, we may consider a vote AGAINST or WITHHOLD vote from the entire board if the whole board was involved in and contributed to egregious compensation. Poor compensation practices include, but are not limited to, the following:

  - Egregious employment contracts (e.g., those containing multi-year guarantees for bonuses and grants);
  - Excessive perks that dominate compensation (e.g., tax gross-ups for personal use of corporate aircraft, personal security systems maintenance and/or installation, car allowances, and/or other inappropriate arrangements);
  - Income tax reimbursements for any executive perquisites or other payments;
  - Abnormally large bonus payouts without justifiable performance linkage or appropriate disclosure;
  - Performance metrics that are changed, canceled or replaced during the performance period without adequate explanation of the action and the link to performance;

- Egregious SERP (Supplemental Executive Retirement Plans) payouts (e.g. inclusion of additional years of service not earned or inclusion performance-based equity awards in the pension calculation);
- New CEO with overly generous new hire package (e.g., including excessive "make whole" provisions or any of the poor pay practices listed under this policy);
- Excessive severance and/or change-in-control provisions (e.g. payments upon an executive's termination in connection with performance failure, provisions for the payment of excise tax gross-ups (including modified gross-ups) and/or modified single-triggers (under which an executive may voluntarily depart for any reason and still receive change-in-control severance payments), perquisites for former executives including car allowances, personal use of corporate aircraft, or other inappropriate arrangements);
- Change-in-control payouts without loss of job or substantial diminution of job duties (single-triggered);
- Liberal change-in-control definitions in individual contracts or equity plans which could result in payments to executives without an actual change in control occurring;
- Poor Disclosure Practices (e.g. unclear explanation of how the CEO is involved in the pay setting process, retrospective performance targets and methodology not discussed, methodology for benchmarking practices and/or peer group not disclosed and explained);
- Internal pay disparity (excessive differential between CEO total pay and that of next highest-paid named executive officer);
- Payment of dividends or dividend equivalents on unvested/unearned performance awards;
- Options backdating (covered in a separate policy);
- Other excessive compensation payouts or poor pay practices at the company.

Moreover, if there is an equity plan proposal on the ballot and the plan is a vehicle for poor pay practices, we may consider voting against the proposal based on past compensation practices.

Stock Option Expensing

The theory that stock options are beneficial to shareholders because they motivate management and align the interests of investors with those of executives is no longer held sacrosanct. The fact that companies reprice underwater options exposes the initial fallacy of this theory. A recent long-term study of stock option awards from the Indiana University School of Business found that there was no correlation whatsoever between executive stock ownership and company performance. Given their accounting treatment of not being charged as an expense against earnings, stock options have been the ultimate tax dodge for companies wishing to lavishly compensate employees.

Misused stock options can give executives an incentive to inflate their company's earnings or make irresponsibly optimistic forecasts in order to keep stock prices high and their paychecks gargantuan. Alan Greenspan cautioned that the failure to expense stock option grants has "introduced a significant distortion in reported earnings, one that has grown with the increasing prevalence of this form of compensation." Some companies have chosen to acknowledge the distortion caused by the non-expensing of options and have committed to expense options going forward. Beginning in 2003, the SEC no longer excludes stock option expensing proposals from the proxy ballot using the ordinary business exception rules.

Vermont managers should support shareholder resolutions calling for stock option grants to be treated as an expense for accounting and earnings calculation purposes and opposes the use of stock options if the stock options are not fully expensed.

Executive Holding Periods

Vermont believes senior level executives should be required to hold a substantial portion of their equity compensation awards, including shares received from option exercises (e.g., 75 percent of their after-tax stock option proceeds), while they are employed at a company. Equity compensation awards are intended to align management interests with those of shareholders, and allowing executives to sell these shares while they are employees of the company undermines this purpose. Given the large size of a typical annual equity compensation award, holding requirements that are based on a multiple of cash compensation may be inadequate.

Performance-Based Options

Stock options are intended to align the interests of management with those of shareholders. However, stock option grants without performance-based elements can excessively compensate executives for stock increases due solely to a general stock market rise, rather than improved or superior company stock performance. When option grants reach the hundreds of thousands, a relatively small increase in the share price may permit executives to reap millions of dollars without providing material benefits to shareholders.

Vermont advocates performance based options, such as premium-priced or indexed, which encourage executives to outperform rivals and the market as a whole rather than being rewarded for any rise in the share price, which can occur if there are not empirical performance measures incorporated into the structure of the options. Additionally, it should be noted that performance-accelerated vesting and premium priced options allow fixed plan accounting, whereas performance-vested and indexed options entail certain expensing requirements.

Vermont managers should:

• Generally vote FOR shareholder proposals that seek to provide for performance-based options such as indexed and/or premium priced options.

Options Backdating

Options backdating has serious implications and has resulted in financial restatements, delisting of companies, and/or the termination of executives or directors. When options backdating has taken place, Vermont may recommend voting AGAINST or WITHHOLDING from the compensation committee, depending on the severity of the practices and the subsequent corrective actions on the part of the board. We will adopt a CASE-BY-CASE approach to the options backdating issue to differentiate companies that had sloppy administration vs. those that had committed fraud, as well as those companies which have since taken corrective action. Instances in which companies have committed fraud are more disconcerting, and Vermont will look to them to adopt formal policies to ensure that such practices will not re-occur in the future. In recommending votes against or withhold votes from the compensation committee members who oversaw the questionable options grant practices or from current compensation committee members who fail to respond to the issue proactively, Vermont will consider several factors, including, but not limited to, the following:

• Reason and motive for the options backdating issue, such as inadvertent vs. deliberate grant date changes;

• Length of time of options backdating;

• Size of restatement due to options backdating;

• Corrective actions taken by the board or compensation committee, such as canceling or repricing backdated options, or recoupment of option gains on backdated grants;

• Adoption of a grant policy that prohibits backdating, and creation of a fixed grant schedule or window period for equity grants going forward.

Pension Plan Income Accounting

• Vermont managers should generally vote FOR shareholder proposals to exclude pension plan income in the calculation of earnings used in determining executive bonuses/compensation.

Shareholder Proposals to Limit Executive and Director Pay

Vermont managers should:

• Generally vote FOR shareholder proposals that seek additional disclosure of executive and director pay information. Current SEC requirements only call for the disclosure of the top five most highly compensated executives and only if they earn more than $100,000 in salary and benefits;

• Generally vote FOR shareholder proposals that seek to eliminate outside directors' retirement benefits; and

• Review on a CASE-BY-CASE basis all other shareholder proposals that seek to limit executive and director pay. This includes shareholder proposals that seek to link executive compensation to customer, employee, or stakeholder satisfaction.

Advisory Vote on Executive Compensation (Say-on-Pay) Shareholder Proposals

• Vermont managers should generally, vote FOR shareholder proposals that call for non-binding shareholder ratification of the compensation of the Named Executive Officers and the accompanying narrative disclosure of material factors provided to understand the Summary Compensation Table.

Advisory Vote on Executive Compensation (Say-on-Pay) Management Proposals

• Vermont managers should vote CASE-BY-CASE on management proposals for an advisory vote on executive compensation. Vote AGAINST these resolutions in cases where boards have failed to demonstrate good stewardship of investors' interests regarding executive compensation practices.

Compensation Consultants - Disclosure of Board Or Company's Utilization

• Vermont managers should generally vote FOR shareholder proposals seeking disclosure regarding the Company, Board, or Compensation Committee's use of compensation consultants, such as company name, business relationship(s) and fees paid.

Golden and Tin Parachutes

Golden parachutes are designed to protect the employees of a corporation in the event of a change-in-control. Under most golden parachute agreements, senior level management employees receive a lump sum pay-out triggered by a change-in-control at usually two to three times base salary. Increasingly, companies that have golden parachute agreements for senior level executives are extending coverage for all their employees via "tin" parachutes. The SEC requires disclosure of all golden parachute arrangements in the proxy statement, while disclosure of tin parachutes in company filings is not required at this time.

Vermont managers should:

• Vote FOR shareholder proposals to have all golden and tin Parachute agreements submitted for shareholder ratification;
• Generally vote AGAINST all management sponsored proposals to ratify golden parachutes; and
• Consider tin parachutes on a CASE-BY-CASE basis.

Executive Perquisites and Retirement/Death Benefits

Vermont supports enhanced disclosure and shareholder oversight of executive benefits and other in-kind retirement perquisites. For example, compensation devices like executive pensions

(SERPs), deferred compensation plans, below-market-rate loans, or guaranteed post-retirement consulting fees can amount to significant liabilities to shareholders and it is often difficult for investors to find adequate disclosure of their full terms. In general, we oppose the provision of any perquisite or benefit to executives that exceeds what is generally offered to other company employees. From a shareholder prospective, the cost of these executive entitlements would be better allocated to performance-based forms of executive compensation during their term in office.

Vermont managers should:

• Generally vote FOR shareholder proposals requesting to put extraordinary benefits contained in SERP agreements to a shareholder vote unless the company's executive pension plans do not contain excessive benefits beyond what is offered under employee-wide plans.

• Generally vote FOR shareholder proposals calling companies to adopt a policy of discontinuing or obtaining shareholder approval for any future agreements and corporate policies that could oblige the company to make payments or awards following the death of a senior executive in the form of unearned salary or bonuses, accelerated vesting or the continuation in force of unvested equity grants, perquisites and other payments or awards made in lieu of compensation. This would not apply to any benefit programs or equity plan proposals that the broad-based employee population is eligible.

Employee Stock Ownership Plans (ESOPs)

An Employee Stock Ownership Plan (ESOP) is an employee benefit plan that makes the employees of a company also owners of stock in that company. Recently, a large Rutgers University study of the performance of ESOPs in closely held companies found that ESOPs appear to increase overall sales, employment, and sales per employee over what would have been expected absent an ESOP. The study also found that ESOP companies are also more likely to still be in business several years later, and are more likely to have other retirement-oriented benefit plans than comparable non-ESOP companies.

Vermont managers should:

• Vote FOR proposals that request shareholder approval in order to implement an ESOP or to increase authorized shares for existing ESOPs except in cases when the number of shares allocated to the ESOP is deemed "excessive" (i.e., generally greater than five percent of outstanding shares).

OBRA Related Compensation Proposals

The enactment of Section 162(m) in OBRA[4] has provided shareholders a set of proxy voting decisions to make with respect to executive compensation which go beyond the familiar task of evaluating stock option plans and other equity-based incentive plan proposals. In addition to

[4] Omnibus Budget Reconciliation Act

considering plan amendments to incorporate administrative features, companies must for the first time submit equity plan performance targets as well as cash or cash-and-stock bonus plans to shareholders for approval in order to preserve the deductibility of bonus amounts over $1 million. With the new rules in place, shareholders supposedly have a greater ability to influence corporate policy with respect to the variable component of executive pay. However, failure to approve the amendment may mean that compensation exceeding the $1 million limit will be nondeductible. Shareholders still do not have a direct say over salary, the fixed-pay component.

Vermont managers should:

• Vote FOR amendments that place a cap on annual grants or amend administrative features;
• Vote FOR plans that simply amend shareholder-approved plans to include administrative features or place a cap on the annual grants that any one participant may receive in order to comply with the provisions of Section 162(m) of OBRA.

Amendments to Add Performance-Based Goals

Section 162(m) of the Internal Revenue Code limits the deductibility of compensation in excess of $1 million to a named executive officer in any given year, unless certain prescribed actions are taken including shareholder approval and the establishment of performance goals.

Vermont managers should:

• Vote FOR amendments to add performance goals to existing compensation plans to comply with the provisions of Section 162(m) of OBRA.

Amendments to Increase Shares and Retain Tax Deductions Under OBRA

Amendments to existing plans to increase shares reserved and to qualify the plan for favorable tax treatment under the provisions of Section 162(m) should be evaluated on a CASE-BY-CASE basis.

Approval of Cash or Cash-and-Stock Bonus Plans

Vermont managers should:

• Generally vote AGAINST cash or cash-and-stock bonus plans to exempt the compensation from taxes under the provisions of Section 162(m) of OBRA if the plan provides for awards to individual participants in excess of $2 million a year; and
• Vote AGAINST plans that are deemed to be "excessive" because they are not justified by performance measures.

STATE OF INCORPORATION

Voting on State Takeover Statutes

Vermont managers should review, on a CASE-BY-CASE basis, proposals to opt in or out of state takeover statutes (including control share acquisition statutes, control share cash-out statutes, freezeout provisions, fair price provisions, stakeholder laws, poison pill endorsements, severance pay and labor contract provisions, anti-greenmail provisions, and disgorgement provisions). We generally support opting into stakeholder protection statutes if they provide comprehensive protections for employees and community stakeholders. We would be less supportive of takeover statutes that only serve to protect incumbent management from accountability to shareholders and that negatively influence shareholder value.

Offshore Reincorporation & Tax Havens

While Vermont generally opposes offshore re-incorporation, for a company that seeks an offshore move, managers should evaluate the merits of questions relating to a move on a CASE-BY-CASE basis, taking into consideration the company's strategic rationale for the move, the potential economic ramifications, potential tax benefits, and any corporate governance changes that may impact shareholders. We believe there are a number of concerns associated with a company looking to reincorporate from the United States to exotic locales such as Bermuda, the Cayman Islands, or Panama. The trend of U.S. companies seeking to move offshore appears to be on the rise, and shareholders are just beginning to understand the web of complexities surrounding the legal, tax, and governance implications involved in such a transaction.

When reviewing a proposed offshore move, Vermont managers should consider the following factors:

• Legal recourse for US stockholders of the new company and the enforcement of legal judgments against the company under the US securities laws;
• The transparency (or lack thereof) of the new locale's legal system;
• Adoption of any shareholder-unfriendly corporate law provisions;
• Actual, qualified tax benefits;
• Potential for accounting manipulations and/or discrepancies;
• Any pending US legislation concerning offshore companies;
• Prospects of reputational harm and potential damage to brand name via increased media coverage concerning corporate expatriation.

Furthermore, while taking the above factors into consideration, Vermont managers should generally support shareholder requests calling for "expatriate" companies that are domiciled abroad yet predominantly owned and operated in America to re-domesticate back to a U.S. state jurisdiction.

CORPORATE RESPONSIBILITY & ACCOUNTABILITY

Special Policy Review and Shareholder Advisory Committees

These resolutions propose the establishment of special committees of the board to address broad corporate policy and provide forums for ongoing dialogue on issues including, but not limited to: shareholder relations, the environment, occupational health and safety, and executive compensation.

• Vermont managers should support these proposals when they appear to offer a potentially effective method for enhancing shareholder value.

Operations in Protected or Sensitive Areas

Operating in regions protected or established under national or international categorization guidelines, including wildlife refuges, national forests, and IUCN categorized areas expose companies to increased oversight and the potential for associated risk and controversy. While it is important for a company to have the flexibility to operate in these regions to take advantage of strategic placement or growth, additional disclosure could be an important mitigating factor when addressing increased risk and oversight. Restrictions to the company's operations, damaging public opinion, and costly litigation resulting from failure to comply with the requirements associated with protected or categorized regions could have a significant impact on shareholder value.

• Vermont managers should generally support shareholder requests for reports outlining potential environmental damage from operations in protected regions, including wildlife refuges, unless the company does not currently have operations or plans to develop operations in these protected regions.

Land Use

Many large retail stores and real estate development firms have received criticism over their policies and processes for acquiring and developing land. Often, in such cases, there are organizations that support as well as those that oppose the proposed development.
Many of these requests brought forth by the respective stakeholders raise serious issues that can have a real impact on short-term shareholder value. However in some cases, additional reporting may be duplicative of existing disclosure or may fail to provide added benefit to shareholders commensurate with the associated cost or burden of providing additional information. Some of the companies targeted with this resolution have been subject to recent litigation and/or significant fines stemming from its land use practices or recent community boycotts.

• Vermont managers should generally support shareholder resolutions that request better disclosure of detailed information on a company's policies related to land use or development or compliance with local and national laws and zoning requirements.

International Financial Related

The rise of globalization has put increasing importance on the need for US companies to periodically monitor their business operations abroad. As a means to preserve brand integrity and protect against potentially costly litigation and negative public relations, Vermont generally supports shareholder proposals which call for a report on the company's core business policies and procedures of its operations outside the United States.

Many of the resolutions which address a company's international policies can include: impact of Foreign Direct Investment (FDI) in emerging market economies; corporate safeguards against money laundering; terrorist financing; economic de-stabilization concerns; relationships with international financial institutions (IFIs); and product sales/marketing abroad (i.e., tobacco, pharmaceutical drug pricing).

• Vermont managers should generally support proposals asking for policy clarification and reporting on foreign-related matters that can materially impact the company's short and long-term bottom-line.

Affirm Political Non-Partisanship

Employees should not be put in a position where professional standing and goodwill within the corporation could be jeopardized as a result of political beliefs. Responsible employment practices should protect workers from an environment characterized by political indoctrination or intimidation. Corporations should not devote resources to partisan political activities, nor should they compel their employees to contribute to or support particular causes. Moreover, it is wise for a corporation to maintain a politically neutral stance as to avoid potentially embarrassing conflicts of interests that could negatively impact the company's brand name with consumers.

• Vermont managers should generally support proposals affirming political non-partisanship within the company.

Political Contributions Reporting & Disclosure

Vermont believes employees should not be put in a position where professional standing and goodwill within the corporation could be jeopardized as a result of political beliefs. Responsible employment practices should protect workers from an environment characterized by political indoctrination or intimidation. Corporations should not devote resources to partisan political activities, nor should they compel their employees to contribute to or support particular causes.

Moreover, we believe it is wise for a corporation to maintain a politically neutral stance so as to avoid potentially embarrassing conflicts of interests that could negatively impact the company's brand name with consumers. Shareholders have the right to know about corporate political activities, and management's knowledge that such information can be made publicly available should encourage a company's lawful and responsible use of political contributions.

Vermont managers should:

• Support proposals affirming political non-partisanship;
• Support reporting of political and political action committee (PAC) contributions; and
• Support establishment of corporate political contributions guidelines and reporting provisions.
• Vote AGAINST shareholder proposals asking to publish in newspapers and public media the company's political contributions as such publications could present significant cost to the company without providing commensurate value to shareholders.

Military Sales

Shareholder proposals from church groups and other community organizations ask companies for detailed reports on foreign military sales. These proposals often can be created at reasonable cost to the company and contain no proprietary data. Large companies can supply this information without undue burden and provide shareholders with information affecting corporate performance and decision-making.

Vermont managers should:
• Generally support reports on foreign military sales and economic conversion of facilities and where such reporting will not disclose sensitive information that could impact the company adversely or increase its legal exposure;

• Generally vote AGAINST proposals asking a company to develop specific military contracting criteria.

Equal Employment Opportunity, Diversity, and Other Work Place Practice Issues

Many proposals generally request that a company establish a policy of reporting to shareholders its progress with equal opportunity and affirmative action programs. The costs of violating federal laws that prohibit discrimination by corporations are high and can affect corporate earnings.

The Equal Opportunities Employment Commission (EEOC) does not release the company's filings to the public unless it is involved in litigation, and the information is difficult to obtain from other sources. Companies need to be very sensitive to minority employment issues as the new evolving work force becomes increasingly diverse. This information can be provided with little cost to the company and does not create an unreasonable burden on management.

Violations of workplace anti-discrimination laws lead to expensive litigation and damaged corporate reputations that are not in the best interest of shareholders. In fact, a commitment to diversity in the workforce can lead to superior financial returns.

Vermont managers should:

• Vote FOR proposals calling for action on equal employment opportunity and anti-discrimination;

• Vote FOR legal and regulatory compliance and public reporting related to non-discrimination, affirmative action, workplace health and safety, environmental issues, and labor policies and practices that affect long-term corporate performance; and
• Vote FOR non-discrimination in salary, wages, and all benefits.

High-Performance Workplace

High-performance workplace practices emphasize employee training, participation, and feedback. The concept of a high-performance workplace has been endorsed by the US Department of Labor and refers to a workplace that is designed to provide workers with the information, skills, incentives, and responsibility to make decisions essential for innovation, quality improvement, and rapid response to changes in the marketplace. These standards embrace a "what's good for the worker is good for the company" philosophy. Studies have shown that improvement in human resources practices is associated with increases in total return to shareholders. High-performance workplace standards proposals can include linking compensation to social measures such as employee training, morale and safety, environmental performance, and workplace lawsuits.

• Vermont managers should generally support proposals that incorporate high-performance workplace standards.

Non-Discrimination in Retirement Benefits

A cash balance plan is a defined benefit plan that treats an earned retirement benefit as if it were a credit from a defined contribution plan, but which provides a stated benefit at the end of its term. Because employer contributions to these plans are credited evenly over the life of a plan and not based on a seniority formula, they may reduce pay-outs to long-term employees who are currently vested in plans.

Cash-balance pension conversions are undergoing congressional and federal agency scrutiny in the wake of high-profile EEOC complaints on age discrimination and employee anger at a number of companies. While significant policy reform is unlikely in the short term, business interests are worried enough that the *National Association of Manufacturers* and other pro-business lobbies are forming a coalition on Capitol Hill to preserve the essential features of the plans and to overturn a recent IRS ruling.

Driving the push behind conversions from traditional pension plans to cash-balance plans are the substantial savings that companies generate in the process. Critics point out that this savings is gained at the expense of the most senior employees. Resolutions call on corporate boards to establish a committee of outside directors to prepare a report to shareholders on the potential impact of pension-related proposals now being considered by national policymakers in reaction to the controversy spawned by the plans.

Vermont managers should:

• Generally support shareholder proposals calling for non-discrimination in retirement benefits; and

Fair Lending Reporting and Compliance

These resolutions call for financial institutions to comply with fair lending laws and statutes while avoiding predatory practices in their sub-prime lending. These predatory practices include: lending to borrowers with inadequate income, who will then default; not reporting on payment performances of borrowers to credit agencies; implying that credit life insurance is necessary to obtain the loan (packing); unnecessarily high fees; refinancing with high additional fees rather than working out a loan that is in arrears (flipping); and high pre-payment fees.

Vermont managers should:
• Generally support proposals calling for full compliance with fair-lending laws;

• Generally support reporting on overall lending policies and data.

MacBride Principles

These resolutions call for the adoption of the MacBride Principles for operations located in Northern Ireland. They request companies operating abroad to support the equal employment opportunity policies that apply in facilities they operate domestically. The principles were established to address the sectarian hiring problems between Protestants and Catholics in Northern Ireland. It is well documented that Northern Ireland's Catholic community faces much higher unemployment figures than the Protestant community. In response to this problem, the U.K. government instituted the New Fair Employment Act of 1989 (and subsequent amendments) to address the sectarian hiring problems.

Many companies believe that the Act adequately addresses the problems and that further action, including adoption of the MacBride Principles, only duplicates the efforts already underway. In evaluating a proposal to adopt the MacBride Principles, shareholders must decide whether the principles will cause companies to divest, and therefore worsen the unemployment problem, or whether the principles will promote equal hiring practices. Proponents believe that the Fair Employment Act does not sufficiently address the sectarian hiring problems. They argue that the MacBride Principles will stabilize the situation and promote further investment.

• Vermont managers should support the MacBride Principles for operations in Northern Ireland that request companies to abide by equal employment opportunity policies.

Contract Supplier Standards

These resolutions call for compliance with governmental mandates and corporate policies regarding nondiscrimination, affirmative action, work place safety and health, and other basic labor protections. Vermont generally supports proposals that:

• Seek publication of a "Worker Code of Conduct" to the company's foreign suppliers and

licensees, requiring they satisfy all applicable labor standards and laws protecting employees' wages, benefits, working conditions, freedom of association, right to collectively bargain, and other rights;
• Request a report summarizing the company's current practices for enforcement of its Worker Code of Conduct;
• Establish independent monitoring programs in conjunction with local and respected religious and human rights groups to monitor supplier and licensee compliance with the Worker Code of Conduct;
• Create incentives to encourage suppliers to raise standards rather than terminate contracts;
• Implement policies for ongoing wage adjustments, ensuring adequate purchasing power and a sustainable living wage for employees of foreign suppliers and licensees;
• Request public disclosure of contract supplier reviews on a regular basis; and
• Adopt labor standards for foreign and domestic suppliers to ensure that the company will not do business with foreign suppliers that manufacture products for sale in the US using forced or child labor or that fails to comply with applicable laws protecting employees' wages and working conditions.

Corporate Conduct, Human Rights, and Labor Codes

Investors, international human rights groups, and labor advocacy groups have long been making attempts to safeguard worker rights in the international marketplace. In instances where companies themselves operate factories in developing countries, for example, these advocates have asked that the companies adopt global corporate standards that guarantee sustainable wages and safe working conditions for their workers abroad. Companies that contract out portions of their manufacturing operations to foreign companies have been asked to ensure that the products they receive from those contractors have not been made using forced labor, child labor, or sweatshop labor. These companies are asked to adopt formal vendor standards that, among other things, include some sort of monitoring mechanism.

Vermont generally supports proposals that call for the adoption and/or enforcement of clear principles or codes of conduct relating to countries in which there are systematic violations of human rights. These conditions include the use of slave, child, or prison labor; undemocratically elected governments; widespread reports of abuse by human rights advocates; fervent pro-democracy protests; or economic sanctions and boycotts.

Globalization, relocation of production overseas, and widespread use of subcontractors and vendors often make it difficult to obtain a complete picture of a company's labor practices in global markets. Efforts that seek greater disclosure on a company's labor practices and that seek to establish minimum standards for a company's operations will be supported. In addition, requests for independent monitoring of overseas operations will be supported.

Many proposals refer to the seven core conventions, commonly referred to as the "Declaration on Fundamental Principles and Rights At Work," ratified by the International Labor Organization (ILO). The seven conventions fall under four broad categories: i) right to organize and bargain collectively; ii) non-discrimination in employment; iii) abolition of forced labor; and

iv) end of child labor. Each of the 180 member nations of the ILO body is bound to respect and promote these rights to the best of its abilities.

Vermont managers should:

• Generally support the principles and codes of conduct relating to company investment and/or operations in countries with patterns of human rights abuses or pertaining to geographic regions experiencing political turmoil (Northern Ireland, Columbia, Burma, former Soviet Union, and China);

• Generally support the implementation and reporting on ILO codes of conduct;

• Generally support independent monitoring programs in conjunction with local and respected religious and human rights groups to monitor supplier and licensee compliance with Codes.

Prepare Report on Operations in Sensitive Regions (i.e., Burma)

Over the past decade, a number of public companies – especially within the extractive sector – have withdrawn from geopolitically sensitive regions as a result of being associated with political controversies involving their host countries (i.e. Myanmar, the Sudan, China, Iran, etc.). Oil and natural gas companies, in particular, continue be the largest investors in many countries involved in human rights abuse and terrorist activities. As such, these companies become targets of consumer boycotts, public relations backlash and even governmental intervention.

Since the early 1960s, Burma (also known as Myanmar) has been ruled by a military dictatorship that has been condemned for human rights abuses, including slave labor, torture, rape, and murder. Many companies have pulled out of Burma over the past decade due to the controversy surrounding involvement in the country. Oil companies continue be the largest investors in Burma, and therefore are the usual targets of shareholder proposals on this topic. However, proposals have also been filed at other companies, including financial companies, for their involvement in the country.

In 1998, the General Assembly of the State of Vermont enacted J.R.H. 157, expressing support for the efforts of the National League for Democracy in Burma and its leader Aung San Suu Kyi. Specifically: 1) The resolution requests that the Governor of the State of Vermont ensure that no state agency, department, or office of state government take any action that would undermine the efforts of the National League for Democracy to achieve its goals; 2) Sound investment policy requires consideration of the risks associated with investment of Vermont pension funds in companies that conduct business in countries with oppressive, nondemocratic governments. For purposes of this act, the portfolios of the Vermont retirement systems shall vote in favor of shareholder resolutions that raise concerns about doing business in Burma.

Vermont managers should:

• Generally support shareholder proposals to adopt labor standards in connection with involvement in Burma and other potentially sensitive geopolitical regions;

• Generally support shareholder proposals seeking reports on Burmese or other sensitive region operations and activities, as well as reports on costs of continued involvement in the country; and

• Consider shareholder proposals to pull out of Burma and other sensitive regions on a CASE-BY-CASE basis considering factors such as overall cost, FDI exposure, level of disclosure to investors, and business focus of the company.

Environmental Reporting

Reports and enhanced disclosure addressing potential environmental liabilities and sustainable development are important to companies because they offer a formal structure for decision-making that helps management teams anticipate and address important risks and global trends that can have serious consequences for business and society. Shareholders may request general sustainability reports on a specific location (i.e., drilling in the Arctic) or operation (i.e., nuclear facility), often requesting that the company detail the environmental, social, legal, and other risks and/or potential liabilities of the specific project in question. A number of companies have begun to report on sustainability issues using established standards in the marketplace. Such reporting focuses on corporate compliance and measurement regarding key economic, environmental, and social performance indicators. Many best practice companies release annual sustainability reports in conjunction with regular annual statement of operations.

Vermont managers should generally vote FOR shareholder proposals seeking greater disclosure on the company's environmental practices, and/or environmental risks and liabilities.

Kyoto Compliance

The Kyoto Protocol was officially ratified in November 2004 and requires the reduction of greenhouse gas emissions by signatory countries in an effort to lower the global emissions of six key greenhouse gasses and address concerns over climate change. While some Kyoto signatory markets have not yet released the details of their respective regulations for companies, it is clear that there will be some significant financial impact on corporate issuers, especially those that operate in industries profoundly impacted by greenhouse gas emission constraints or regulation. In order to comply with the anticipated standards, companies will have to consider options such as: capital improvement to their facilities to reduce emissions, the cost of "trading" carbon credits on an open market to offset emission overages, or the expense of fines or restrictions resulting from noncompliance.

• Vermont managers should generally support resolutions requesting that companies outline their preparations to comply with standards established by Kyoto Protocol signatory markets, unless: 1) The company does not maintain operations in Kyoto signatory markets; or 2) The company already evaluates and substantially discloses such information to shareholders; or, 3) Greenhouse gas emissions do not materially impact the company's core businesses.

Global Warming/Greenhouse Gas Emissions

Scientists generally agree that gases released by chemical reactions including the burning of fossil fuels contribute to a "greenhouse effect" that traps the planet's heat leading to changing climate patterns, violent weather swings, melting glaciers, rising sea levels, and receding coastlines.

Vermont managers should generally vote FOR shareholder proposals calling for the reduction of greenhouse gas emissions under a reasonable timeline.

Invest in Clean/Renewable Energy

Filers of proposals on renewable energy ask companies to increase their investment in renewable energy sources and to work to develop products that rely more on renewable energy sources. Increased use of renewable energy will reduce the negative environmental impact of energy companies. In addition, as supplies of oil and coal exist in the earth in limited quantities, renewable energy sources represent a competitive, and some would even argue essential, long-term business strategy.

Vermont managers should:

• Generally support shareholder proposals seeking increased investment in renewable energy sources, taking into account whether the terms of the resolution are realistic or overly restrictive for management to pursue.

• Generally vote FOR shareholder proposals calling for a company to commit to reducing its greenhouse gas emissions under a reasonable timeline.

Sustainability Reporting and Planning

The concept of sustainability is commonly understood as meeting the needs of the present generation without compromising the ability of future generations to meet their own needs. Indeed, the term sustainability is complex and poses significant challenges for companies on many levels. Many in the investment community have termed this broader responsibility the "triple bottom line," referring to the triad of performance goals related to economic prosperity, social responsibility and environmental quality. In essence, the concept requires companies to balance the needs and interests of their various stakeholders while operating in a manner that sustains business growth for the long-term, supports local communities and protects the environment and natural capital for future generations.

Reporting and enhanced disclosure addressing sustainable development is important to companies namely because it offers a formal structure for decision making that helps management teams anticipate and address important global trends that can have serious consequences for business and society. Shareholders may request general sustainability reports on a specific location (i.e. drilling in ANWR) or operation (i.e. nuclear facility), often requesting that the company detail the environmental, social, legal and other risks and/or potential liabilities of the specific project in question.

A number of companies have begun to report on sustainability issues using established standards in the marketplace. Such reporting focuses on corporate compliance and measurement regarding key economic, environmental, and social performance indicators. Many best practice companies release annual sustainability reports in conjunction to regular annual statement of operations.

Vermont managers should:

• Generally support shareholder proposals seeking greater disclosure on the company's environmental practices, and/or environmental risks and liabilities.

Endorsement of CERES Principles

These resolutions call for the adoption of principles that encourage the company to protect the environment and the safety and health of its employees. The CERES Principles, formulated by the Coalition of Environmentally Responsible Economies, require signing companies to address environmental issues, including protection of the biosphere, sustainable use of natural resources, reduction and disposal of wastes, energy conservation, and employee and community risk reduction. A signee to the CERES Principles would disclose its efforts in such areas through a standardized report submitted to CERES and made available to the public.

Evidence suggests that environmentally conscious companies may realize long-term savings by implementing programs to pollute less and conserve resources. In addition, environmentally responsible companies stand to benefit from good public relations and new marketing opportunities. Moreover, the reports that are required of signing companies provide shareholders with more information concerning topics they may deem relevant to their company's financial well-being. Roughly thirty public companies have voluntarily adopted these principles.

Vermont supports proposals that improve a company's public image, reduce exposure to liabilities, and establish standards so that environmentally responsible companies and markets are not at a competitive financial disadvantage.

Vermont managers should:
• Generally support requests asking a company to formally adopt the CERES Principles;

• Generally support the adoption of reports to shareholders on environmental issues

Adopt a Comprehensive Recycling Policy

A number of companies have received proposals to step up their recycling efforts, with the goal of reducing the company's negative impact on the environment and reducing costs over the long term.

• Vermont managers should vote FOR shareholder proposals that ask companies to increase their recycling efforts or to adopt a formal recycling policy.

Phase-Out or Label Products Containing Genetically Engineered Ingredients

Shareholders ask companies engaged in the development of genetically modified agricultural products to adopt a policy of not marketing or distributing such products until "long-term safety testing" demonstrates that they are not harmful to humans, animals, or the environment. Until further long-term testing demonstrates that these products are not harmful, companies in the restaurant and prepared foods industries are being asked to remove genetically altered ingredients from products they manufacture or sell, and label such products in the interim. Shareholders are asking supermarket companies to do the same for their own private label brands.

Vermont managers should:
• Vote FOR shareholder proposals to label products that contain genetically engineered products.

• Generally vote AGAINST proposals calling for a full phase out of product lines containing GMO ingredients.

Tobacco-Related Proposals

Shareholders file resolutions annually asking that companies with ties to the tobacco industry account for their marketing and distribution strategies, particularly as they impact smoking by young people.

Vermont managers should:
• Vote FOR shareholder proposals seeking to limit the sale of tobacco products to children.

• Generally vote AGAINST proposals calling for a full phase out of tobacco related product lines

Drug Pricing

Shareholder proponents, activists, and even some legislators have called upon drug companies to restrain pricing of prescription drugs. Against the backdrop of the AIDS crisis in Africa, shareholders have called on companies to address the issue of affordable drugs for the treatment of AIDS, as well as TB and Malaria.

• Proposals asking a company to implement price restraints on its pharmaceutical products will be evaluated on a CASE-BY-CASE basis, taking into account the following factors:

- o Whether the proposal focuses on a specific drug and region;
- o Whether the economic benefits of providing subsidized drugs (e.g., public goodwill) outweigh the costs in terms of reduced profits, lower R&D spending, and harm to competitiveness;
- o The extent that reduced prices can be offset through the company's marketing expenditures without significantly impacting R&D spending;
- o Whether the company already limits price increases of its products;
- o Whether the company already contributes life-saving pharmaceuticals to the needy and Third World countries;
- o The extent to which peer companies implement price restraints.

Vermont managers should:

• Generally support proposals requesting that companies implement specific price restraints for its pharmaceutical products in developing markets or targeting certain population groups.

• Generally support proposals requesting that the company evaluate their global product pricing strategy, considering the existing level of disclosure on pricing policies, any deviation from established industry pricing norms, and the company's existing philanthropic initiatives.

• Vote FOR shareholder proposals that call on companies to develop a policy to provide affordable HIV, AIDS, TB and Malaria drugs to citizens in the developing world.

Toxic Emissions

Shareholder proposals asking companies to take steps to minimize their emissions of toxic chemicals or release of toxic waste into the environment can vary greatly. Some focus on reporting on the impact of these chemicals on the communities in which the company operates. Still others ask for a review of the company's efforts to minimize pollution.

• Vermont managers should generally support shareholder proposals calling on the company to establish a plan reduce toxic emissions.

Toxic Chemicals

The use of toxic chemicals in cosmetics, consumables, and household products has become a growing issue of concern for shareholders as international regulations on this topic continue to expand, providing increased scrutiny over potentially toxic materials or compounds used or emitted in the conduct of operations or as an ingredient in consumer goods. Shareholders must recognize the impact that changing regulation and consumer expectations could have on shareholder value and should encourage companies to disclose their policies regarding the use or emission of toxic chemicals. Specific considerations should be made for a company's geographic markets and the appearance of historical difficulties with controversy, fines, or litigation, requests for disclosure on the potential financial and legal risk associated with toxic chemicals.

Vermont managers should:

• Generally support resolutions requesting that a company discloses its policies related to toxic chemicals;

• Generally support shareholder resolutions requesting that companies evaluate and disclose the potential financial and legal risks associated with utilizing certain chemicals;

Nuclear Safety

These resolutions are filed at companies that manage nuclear power facilities or produce components for nuclear reactors to request disclosure on the risks to the company associated with these operations, including physical security and the potential for environmental damage. Current reporting requirements for companies that operate nuclear facilities are managed by the Nuclear Regulatory Commission (NRC) and include detailed reports on safety and security that are available to the public.

• Vermont managers should generally support shareholder resolutions requesting that companies report on risks associated with their nuclear reactor designs and/or the production and interim storage of irradiated fuel rods.

Concentrated Area Feeding Operations (CAFOs)

The level of pollution resulting from CAFOs has drawn increased attention in recent years as certain legal decisions have established the precedent that a company can be held liable for the actions of the contract farms it sources from. Fines and remediation expenses stemming from these cases have been significant and could have a notable impact on the companies' operations and shareholder value.

• Vermont managers should generally support resolutions requesting that companies report to shareholders on the risks and liabilities associated with concentrated animal feeding operations (CAFOs) unless the company has publicly disclosed guidelines for its corporate and contract farming operations, including compliance monitoring or if the company does not directly source from CAFOs.

Pharmaceutical Product Reimportation

One of the most visible aspects of the legal and political debate over rising health care costs in the United States can be seen through prescription drug reimportation through Canada. While U.S. and Canadian regulations limit reimportation, several states have taken steps to encourage employees to actively seek less expensive medications through reimportation.

Shareholder action at major pharmaceutical companies has requested increased disclosure of the financial and legal risks associated with company policies, or called on companies to change distribution limits to increase product availability in Canada, thereby encouraging product reimportation to the United States. The level of public concern over this issue and associated impact that a poorly developed policy could have on the companies suggest that additional disclosure of company policies related to reimportation could be beneficial to shareholders and generally merits support.

Vermont managers should:

• Generally support shareholder proposals requesting that companies report on the financial and legal impact of their policies regarding prescription drug reimportation, unless such information is already publicly disclosed.

• Generally support shareholder proposals requesting that companies adopt specific policies to encourage or not constrain prescription drug reimportation.