



Independent Board and
Management Advisors

Client Alert

Fidelity Issues 2011 Proxy Voting Guidelines

Recently, Fidelity issued its 2011 Proxy Voting Guidelines.¹ As promised, the new guidelines are a significant departure from Fidelity's past guidelines in the area of equity compensation plan proposals. A full summary of the portions of the new guidelines related to compensation appear in the Appendix. In years past, Fidelity looked to dilution as the guiding principle along with assorted other concerns in determining its vote on equity compensation plan proposals. The dilution guideline has now been replaced with a 3-year average burn rate guideline. Under the new guidelines, Fidelity will generally vote against equity compensation plans or amendments to authorize additional shares if the company's average 3-year burn rate exceeds:

- 1.5% for Large Caps—companies in the Russell 1000 Index;
- 2.5% for Small Caps—companies not in the Russell 1000 Index; or
- 3.5% for Micro Caps—companies with a market cap under U.S. \$300 million; **and**
- There are no circumstances specific to the company that would lead Fidelity to conclude that the burn rate is acceptable.

We believe the following information we have gathered about the guidelines is correct, but have been unable to verify it directly with Fidelity.²

- The new guidelines, including the burn rate policy for equity compensation plan proposals, are effective immediately.
- Fidelity will not use a multiplier for full-value awards (awards other than stock options or stock appreciation rights that are settled by the issuance of shares). In other words, the calculation is based on a simple burn rate defined as options granted during the fiscal year + full-value awards granted during the fiscal year ÷ weighted average common shares outstanding.³
- Fidelity will be considering mitigating factors to permit it to support a plan when a company has a burn rate that exceeds the burn rate cap (similar to what Fidelity did with its prior dilution caps). But, Fidelity is still working out the details on the exceptions.

¹ Available at: <http://personal.fidelity.com/myfidelity/InsideFidelity/InvestExpertise/governance.shtml.tvsr>

² A special thanks to Reid Pearson at Alliance Advisors LLC for the information he shared with us.

³ This is the "Traditional Burn Rate" in Ed Hauder's 2011 Burn Rate Calculator, available on his [blog](http://EdwardHauder.com), EdwardHauder.com, and this is reported on ISS's Proxy Reports as the "unadjusted burn rate."

Exequity Comment

There are several open questions regarding these new guidelines, such as:

- In addition to looking at the historical 3-year average burn rate, will Fidelity also evaluate the proposed burn rate based on the size of the share request and how many years it might last?
- Will exceptions be made for extraordinary situations that cause a spike in equity grants compared to typical practice?
- Will Fidelity make allowances to its general burn rate caps for companies in various industry groups that have historically had higher burn rates (e.g., the technology and biotech industries)? If not, what will this mean for these companies' ability to gain shareholder approval of equity compensation plan proposals and continue to make use of equity awards as part of their compensation packages?

We will have to wait and see how Fidelity ends up developing these guidelines to evaluate what the practical implications will be for new share requests (where Fidelity support is desired).



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Appendix: Summary of Fidelity's 2011 Proxy Voting Guidelines Related to Compensation

Provision	Guidelines
Say on Pay	<p>Fidelity will generally vote for SOP unless compensation appears misaligned with shareholder interests or otherwise problematic, taking into account certain factors, including:</p> <ul style="list-style-type: none"> • Whether the company has an independent compensation committee; • Whether the compensation committee engaged independent compensation consultants; • Whether the compensation committee has lapsed or waived equity vesting restrictions; and • Whether the company has adopted or extended a Golden Parachute without shareholder approval. <p>"Golden Parachute" means employment contracts, agreements, or policies that include an excise tax gross-up provision; single-trigger for cash incentives; or may result in a lump-sum cash payment and acceleration of equity that may total more than three times annual compensation (salary and bonus) in the event of a termination following a change in control.</p>
Say When on Pay	Fidelity will generally support annual SWOP votes.
Say on Golden Parachutes	Fidelity will generally vote against SOGP votes.
Equity Compensation Plans	<p>Fidelity will generally vote against equity compensation plans or amendments to authorize additional shares under such plans if:</p> <ul style="list-style-type: none"> • Burn Rate: <ul style="list-style-type: none"> — The company's average 3-year burn rate is greater than: <ul style="list-style-type: none"> – 1.5% for a Large-Capitalization Company; – 2.5% for a Small-Capitalization Company; or – 3.5% for a Micro-Capitalization Company; and — There are no circumstances specific to the company or the plans that lead Fidelity to conclude that the burn rate is acceptable. • Stock Options: <ul style="list-style-type: none"> — Exercise price is less than 100% of fair market value on the date of grant, except can be as low as 85% if expressly granted in lieu of salary or cash bonus; — Plan allows repricing; or — Board/committee has repriced stock options in the past 2 years without shareholder approval. • Stock Vesting: The restriction period is less than 3 years for non-performance-based awards, and less than 1 year for performance-based awards. <ul style="list-style-type: none"> — Fidelity will consider approving a plan or amendment that does not meet the above stock vesting requirements if the following two conditions are met: <ul style="list-style-type: none"> – The shares are granted by a compensation committee composed entirely of independent directors; and – The shares are limited to 5% (Large-Capitalization Company) and 10% (Small- or Micro-Capitalization Company) of the shares authorized for grant under the plan.

Provision	Guidelines
	<ul style="list-style-type: none"> • The plan includes an evergreen provision. • The plan provides for the acceleration of vesting of equity awards even though an actual change in control may not occur.
Equity Exchanges and Repricings	<p>Fidelity will generally vote in favor of a management proposal to exchange, reprice, or tender for cash, outstanding stock options if the proposed exchange, repricing, or tender offer is consistent with the interests of shareholders, taking into account such factors as:</p> <ul style="list-style-type: none"> • Whether senior management and directors were excluded; • Whether the exchange or repricing is value-neutral to shareholders based upon an acceptable pricing model; • The company's relative performance compared to other companies within the relevant industry or industries; • Economic and other conditions affecting the relevant industry or industries in which the company competes; and • Any other factors or circumstances relevant to determining whether an exchange or repricing proposal is consistent with the interests of shareholders.
Employee Stock Purchase Plans (ESPPs)	<p>Fidelity will generally vote in favor of ESPPs if the minimum purchase price is equal to or greater than 85% of the stock's fair market value and the plan constitutes a reasonable effort to encourage broad-based participation in the company's equity.</p>
Employee Stock Purchase Plans (ESOPs)	<p>Fidelity will generally vote in favor of nonleveraged ESOPs. For leveraged ESOPs, Fidelity may examine the company's state of incorporation, existence of supermajority vote rules in the charter, number of shares authorized for the ESOP, and number of shares held by insiders. Fidelity might also examine where the ESOP shares are purchased and the dilution effect of the purchase. Fidelity will generally vote against leveraged ESOPs if all outstanding loans are due immediately upon change in control.</p>
Bonus Plans and Tax Deductibility Proposals	<p>Fidelity will generally vote in favor of cash and stock incentive plans that are submitted for shareholder approval in order to qualify for favorable tax treatment under Section 162(m) of the Internal Revenue Code, provided that the plan includes well-defined and appropriate performance criteria, and with respect to any cash component, that the maximum award per participant is clearly stated and is not unreasonable or excessive.</p>
Incumbent Directors	<p>Fidelity will generally vote in favor of incumbent and nominee directors except where one or more such directors clearly appear to have failed to exercise reasonable judgment or if, among other things:</p> <ul style="list-style-type: none"> • Within the last year and without shareholder approval, a company's board or compensation committee repriced outstanding stock options, exchanged outstanding stock options for equity, or tendered cash for outstanding stock options. • To gain Fidelity's support on a proposal, the company made a commitment to modify a proposal or practice to conform to Fidelity's guidelines and the company failed to act on that commitment. • Executive compensation appears misaligned with shareholder interests or otherwise problematic, taking into account such factors as: <ul style="list-style-type: none"> — Whether the company has an independent compensation committee; — Whether the compensation committee engaged independent compensation consultants; — Whether the compensation committee has lapsed or waived equity vesting restrictions; and — Whether the company has adopted or extended a Golden Parachute without shareholder approval.