

Behind the Curtain

*How the 10 Largest Mutual Fund Families Voted
When Presented with 12 Opportunities
To Curb CEO Pay Abuse in 2004*

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Executive Summary

On August 31, 2004, for the first time, the nation's mutual fund companies reported how they cast their proxy votes at the public companies in which they invest. The disclosure is the result of Securities and Exchange Commission rules adopted in January 2003, rules that the AFL-CIO first petitioned for in December 2000 and that the mutual fund industry strenuously opposed.

This report evaluates how the 10 largest mutual fund families voted when presented with the opportunity to curb CEO pay abuses at a dozen S&P 500 companies in 2004. We chose executive compensation as our benchmark because, in the words of billionaire investor Warren Buffet, "The acid test for reform will be CEO compensation."

We found that, when it comes to voting proxies on proposals involving CEO pay abuses, there is significant variation among fund families. The scores in our survey ranged from a high of 100% for American Century to a low of 20% for Putnam.

Fidelity, the nation's largest fund family and the most vocal opponent to proxy vote disclosure, ranked 9th out of 10 in our survey with a 25% score. Vanguard, the other leading opponent to proxy vote disclosure, ranked 2nd in the survey with a 75% score.

Although the SEC rule does not require mutual funds to disclose business relationships with portfolio companies, our own research indicates that, of the 120 proxy voting decisions in this survey, 25 involved a mutual fund advisor that has a business relationship with the portfolio company.

These widespread conflicts of interest not only underline the importance of transparent proxy voting by mutual funds, but also point to the need to enhance the SEC rule to require mutual fund advisors to disclose business relationships with portfolio companies.

Mutual Funds and Proxy Voting Disclosure

On August 31, 2004, for the first time, the nation's mutual fund companies reported how they cast their proxy votes at the public companies in which they invest on behalf of their mutual fund shareholders. The disclosure is the result of new Securities and Exchange Commission rules adopted in January 2003, rules that the AFL-CIO first petitioned for in December 2000 and that the mutual fund industry strenuously opposed.

Now mutual fund companies must do what investment firms that manage private pension plans have long been required to do by the Department of Labor—tell their clients how they cast proxy votes on their behalf at the annual shareholder meetings that every public corporation holds. At these meetings, shareholders have the responsibility to vote on the critical decisions shaping each company's governance—decisions such as who will serve on the board of directors, how the CEO will be paid and what general policies the shareholders will recommend to the company's board. Casting proxy votes on these issues is the most direct means for shareholders to oversee the corporations they own.

Millions of working families, including more than six million union households, invest their retirement savings in mutual funds, yet have been kept in the dark as to how mutual funds use their money to influence corporate elections.¹ For these families, proxy vote disclosure represents a long-overdue victory. Moreover, if greater transparency of mutual fund proxy voting leads the \$7.4 trillion mutual fund industry to become more engaged in corporate governance, as the SEC reasoned in issuing its final rule, it will benefit all public company investors and not just fund shareholders.²

Mutual funds own 22% of U.S. corporate stock, so their proxy votes on such issues as CEO pay and director elections can be decisive.³ While mutual funds have a legal duty to cast these votes in the best interests of their investors, mutual fund firms can have an economic interest in voting with management even if such votes may not be in the interest of fund investors. This conflict of interest stems from mutual fund firms' desire to sell lucrative 401(k) management and other financial services to the same companies at which they vote proxies on behalf of mutual fund investors.

It is this conflict that may lead mutual funds to act as rubberstamps for corporate management regardless of the best interests of their investors. To provide the transparency necessary to rein in this conflict, the AFL-CIO petitioned the SEC in December 2000 to adopt rules requiring disclosure of mutual fund proxy votes. In the wake of subsequent scandals at companies like Enron, WorldCom and Tyco, the AFL-CIO again called in the SEC in July 2002 to require mutual funds to disclose their votes.

When the SEC responded with a proposed rule in September 2002, a then-record 8,000 individual and institutional investors sent comment letters to the SEC, the overwhelming majority in support of disclosure.⁴ Only the mutual fund industry, led by Fidelity Investments and Vanguard, opposed it. Despite intense industry opposition, the SEC voted 4-1 to approve the proposed rule in January 2003, and established August 31, 2004 as the deadline for disclosure of votes cast during the year ending the June 30, 2004.

¹ 45% of the nation's 13 million unionized workers participate in defined contribution plans, according to "National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2003," U.S. Bureau of Labor Statistics, April 2004. Many union members who do not participate in defined contribution plans invest directly in mutual funds.

² *2004 Mutual Fund Fact Book*, 44th Edition, Investment Company Institute, 2004. Equity funds account for \$3.68 trillion of the \$7.4 trillion in total mutual funds assets. "Final Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies", SEC, Release Nos. 33-8188, 34-47304, IC-25922, January 31, 2003.

³ *2004 Mutual Fund Fact Book*, 44th Edition, Investment Company Institute, 2004.

⁴ *Ibid.*

As a result, mutual fund investors now have the information necessary to determine if the votes mutual fund companies cast truly represent investors' best interests, as required by law, and do not represent an effort to curry favor with the CEOs of portfolio companies in order to win lucrative contracts for managing employee benefit plans.

To mark the release of the mutual fund proxy votes--and enable investors to more easily evaluate and interpret their fund's voting practices--the AFL-CIO prepared this report evaluating how the nation's ten largest mutual fund families cast their proxy votes in 2004 on executive pay proposals at twelve S&P 500 companies with clearly excessive CEO pay and poor performance. We chose executive compensation as our benchmark because, in the words of billionaire investor Warren Buffet, "The acid test for reform will be CEO compensation."⁵ The report also highlights business relationships between the mutual fund firms and the twelve companies.

We encourage mutual fund investors and 401(k) plan trustees to use this report to evaluate whether their mutual fund company, or a mutual fund company that they are considering, is casting its proxy votes in a way that is consistent with their best interests.

Mutual Funds and Executive Compensation

Corporate governance experts have long been concerned by the failure of mutual fund companies to challenge management on corporate governance. The consequences of their conflicted voting practices are perhaps most apparent in the skyrocketing CEO pay over the past two decades. In 1980, CEO pay stood at approximately 42 times the average worker. In 2003, CEO pay reached 301 times the average worker's pay.⁶ The majority of this increase has been due to stock options, which have become the biggest component of today's CEO pay packages.

The AFL-CIO supports reasonable and just compensation for all workers, including executives. But by any standard, many of today's executive compensation packages are excessive and bear no relationship to performance. In 2003, for example, earnings for the US's largest 500 companies grew by a median of 9.6 percent, while the median total pay for the chief executives at these companies jumped by 22 percent.⁷ These executive pay excesses come at the expense of shareholders, as well as the company and its employees.

The disconnect between CEO pay and long-term corporate performance remains the biggest failure of our corporate governance system. As Richard Breeden, former chairman of the Securities and Exchange Commission, recently warned, "We have not made any progress on pervasive abuses in the compensation process and that is the root of most of the big frauds."⁸

Although shareholders do not have the ability to vote on every component of executive compensation, all companies are required to obtain shareholder approval of their equity compensation plans, including stock options. In addition, shareholders vote on resolutions submitted by fellow shareholders seeking to rein in runaway CEO pay. These shareholder resolutions, for example, call on companies to expense stock options, to require that future equity compensation grants to senior executives be performance-based, or to submit executive severance agreements ("golden parachutes") to a shareholder vote.

⁵ Letter to Shareholders, Berkshire Hathaway Inc. 2002 Annual Report, February 21, 2003.

⁶ *Business Week*, as reported in Anderson, Sarah et al, *Executive Excess 2004*, Institute for Policy Studies and United For a Fair Economy, August 31, 2004.

⁷ Michaels, Adrian, "Off the Leash: What Will Bring Executive Pay Under Control?", *Financial Times*, August 24, 2004. Hodgson, Paul, *CEO Pay 2003*, The Corporate Library, July 2004.

⁸ Michaels, Adrian, "Off the Leash: What Will Bring Executive Pay Under Control?", *Financial Times*, August 24, 2004.

In this report, we look at how the nation's largest mutual fund families cast their proxy votes on a representative cross-section of executive compensation proposals at twelve S&P 500 companies with clearly excessive CEO pay and poor performance. For each of the twelve votes, the report includes a case study that describes the executive compensation abuse and the issue on which shareholders were asked to vote.

Methodology and Sources

Under the new SEC disclosure rule, each mutual fund associated with a fund family is required to disclose its proxy votes. Because large mutual fund companies such as Fidelity act as advisors to hundreds of mutual funds, a particular stock may be held by dozens of separate mutual funds within a particular fund family. In many cases, mutual fund families cast their proxy votes as block, but this is not always the case.

For example, Fidelity index funds, which are managed by Geode Capital under a sub-advisory arrangement, use separate proxy voting guidelines from other Fidelity funds. As a result, Fidelity index funds did not vote in the same way as its non-index funds on many votes. We also observed that Janus and T. Rowe price mutual funds did not always vote as a block.

Therefore, the proxy votes disclosed in this report represent the vote cast by what we estimate to be the majority of the shares of a particular stock held by a mutual fund family. These estimates are based on recent shareholder data from LionShares, which is compiled primarily from SEC Form 13-F and N-30D filings. We caution, however, that the portfolio data for a mutual fund may not correspond to the fund's portfolio on the record date for a particular shareholder meeting.

To identify potential business relationships between the adviser to a mutual fund family and the twelve S&P 500 companies, we relied on databases provided by Nelson's Marketplace and Larkspur DataMaster Pro. Both of these sources aggregate data from the Form 5500s that corporate retirement plans are required to file with the Department of Labor.

Key Findings

- When it comes to voting proxies on proposals involving CEO pay abuses, there is significant variation among fund families. The scores in our survey ranged from a high of 100% for American Century to a low of 20% for Putnam. Putnam was also the only fund that failed to cast a vote at a portfolio company included in this survey (Putnam did not vote on a CSX shareholder proposal to rein in golden parachutes or on any other issue subject to a vote at CSX's 2004 annual meeting).
- The survey results indicate that the SEC rule requiring mutual fund proxy vote disclosure appears to have had a significant impact on the voting practices of some fund families. In the 1990s, mutual funds reflexively voted with management, regardless of the best interests of their mutual fund investors. While this still appears to be the case at some fund families, others appear to be increasingly willing to oppose management when necessary to protect long-term shareholder value.
- Fidelity, the nation's largest fund family and the most vocal opponent to proxy vote disclosure, ranked 9th out of 10 in our survey with a 25% score. Fidelity voted against all eight shareholder proposals to rein in runaway CEO pay, but also opposed three of the four management proposals.
- Vanguard, the other leading opponent to proxy vote disclosure, ranked 2nd in the survey with a 75% score. Vanguard was one of only two mutual fund families that voted against all four management proposals seeking excessive executive compensation (American Century was the other).
- There was only one proposal for which all of the mutual fund families holding the stock voted in the same way. Nine fund families voted against a management proposal seeking to renew the Stock Incentive Plan at Broadcom (American Funds did not hold the stock). This is perhaps no surprise, since an overwhelming majority (89 percent) of Class A shares voted against the plan. As *The New York Times* observed about Broadcom, "just when you thought you had seen the most outrageous transfer of shareholder wealth to executives through stock options, along comes a company that tops them all."⁹ Unfortunately, the proposal passed over the objection of outside shareholders because the company's dual class stock structure gives insiders disproportionate voting power.
- One shortcoming of the SEC rule is that it does not allow investors to determine whether a conflict of interest compromised their mutual fund's proxy vote at a particular company, since the rule does not require mutual funds to disclose their business relationships with the portfolio companies. Our own research indicates that, of the 120 proxy voting decisions reported in this survey, 25 involved a mutual fund advisor that has a business relationship with the portfolio company. Fidelity maintained the most business relationships (8), followed by Capital Research and Management (as advisor to the American Funds) (5), and Vanguard (4).
- These widespread conflicts of interest not only underline the importance of transparent proxy voting by mutual funds, but also point to the need to enhance the SEC rule to require mutual fund companies to disclose business relationships with portfolio companies.

⁹ Gretchen Morgenson, "Bubble Lives on at Broadcom, Where Options Still Rain Down," *The New York Times*, April 18, 2004.

Top 10 Mutual Fund Families by Net Assets¹

Rank	Mutual Fund Family	Assets (\$Bil)
1.	Fidelity	\$513
2.	American Funds	393
3.	Vanguard	355
4.	Franklin Templeton	100
5.	Putnam	98
6.	T. Rowe Price	75
7.	Janus	72
8.	AIM Investments	67
9.	Oppenheimer Funds	56
10.	American Century	55

¹Includes only stock funds available to individuals

Source: Morningstar, as reported in the *New York Times*, February 8, 2004.

Top 10 Mutual Fund Families by Voting Score

Rank	Mutual Fund Family	Voting Score
1.	American Century	100%
2.	Vanguard	75%
3.	Janus	71%
4.	Oppenheimer Funds	70%
5.	T. Rowe Price	58%
6.	American Funds	50%
7.	Franklin Templeton	45%
8.	AIM Investments	30%
9.	Fidelity	25%
10.	Putnam	20%

Mutual Fund Proxy Voting Scorecard -- Executive Compensation, 2004

Shareholder Proposals (Votes "FOR" These Proposals Support Limiting Excessive Executive Pay)									
Company	2004 Meeting	Item	Proposal	Fidelity¹⁰	American Funds	Vanguard	Franklin-Templeton	Putnam	
Allergan	April 28	#3	Expense Stock Options	Against	For*	For	For	Against	
CSX	May 5	#5	Golden Parachutes	Against*	n.a.	For*	n.a.	Not Cast	
Delta	April 23	#5	Executive Pensions	Against*	Against	Against	Against*	n.a.	
Kohl's	April 28	#3	Performance-based Pay	Against	Against	Against*	Against	Against*	
Lucent	Feb 18	#5	Golden Parachutes	Against*	n.a.	For	Against	n.a.	
PeopleSoft	March 25	#3	Expense Stock Options	Against	For	For	For	Against	
Raytheon	May 5	#7	Expense Stock Options	Against*	For*	For*	For	Against	
Sprint	April 20	#3	Performance-based Pay	Against*	Against*	Against	For	Against	
Management Proposals (Votes "AGAINST" These Proposals Support Limiting Excessive Executive Pay)									
Bear Stearns	March 31	#2	Capital Accumulation Plan	For*	n.a.	Against	For	For	
Broadcom	April 29	#2	Stock Incentive Plan	Against*	n.a.	Against	Against	Against	
Delphi	May 6	#4	Long-Term Incentive Plan	Against*	Against*	Against	For	Against*	
Union Pacific	April 16	#2	Stock Incentive Plan	Against	For*	Against*	For	For	
Vote Tally				3 of 12	4 of 8	9 of 12	5 of 11	2 of 10	
				Score	25%	50%	75%	45%	20%

n.a. – not applicable given no shareholdings identified within mutual fund family.

*Nelson's Marketplace and/or Larkspur DataMaster Pro report business relationship between the mutual fund advisor and company.

¹⁰ Fidelity index funds are managed by Geode Capital and in many cases cast different votes from the Fidelity-managed funds. In all of the above cases the lion's share of Fidelity's stock was held in the Fidelity-managed funds.

Mutual Fund Proxy Voting Scorecard -- Executive Compensation, 2004

<u>Shareholder Proposals</u> (Votes "FOR" These Proposals Support Limiting Excessive Executive Pay)									
Company	2004 Meeting	Item	Proposal	T. Rowe Price	Janus	AIM ¹¹	Oppenheimer Funds	American Century	
Allergan	April 28	#3	Expense Stock Options	Against	Against*	Against	n.a.	For*	
CSX	May 5	#5	Golden Parachutes	For	n.a.	n.a.	Against	For*	
Delta	April 23	#5	Executive Pensions	For	n.a.	n.a.	For	For	
Kohl's	April 28	#3	Performance-based Pay	For	For ¹²	Against	n.a.	For	
Lucent	Feb 18	#5	Golden Parachutes	For	n.a.	Against	Against	For	
PeopleSoft	March 25	#3	Expense Stock Options	Against ¹³	For	Against	For	For	
Raytheon	May 5	#7	Expense Stock Options	Against	n.a.	Against	For	For*	
Sprint	April 20	#3	Performance-based Pay	For	For	For	For	For	
<u>Management Proposals</u> (Votes "AGAINST" These Proposals Support Limiting Excessive Executive Pay)									
Bear Stearns	March 31	#2	Capital Accumulation Plan	Against	Against	Against	Against	Against	
Broadcom	April 29	#2	Stock Incentive Plan	Against	Against	Against	Against	Against	
Delphi	May 6	#4	Long-Term Incentive Plan	For*	n.a.	For	For	Against	
Union Pacific	April 16	#2	Stock Incentive Plan	For	For	For	Against	Against	
Vote Tally				7 of 12	5 of 7	3 of 10	7 of 10	12 of 12	
Score				58%	71%	30%	70%	100%	

n.a. – not applicable given no shareholdings identified within mutual fund family.

* Nelson's Marketplace and/or Larkspur DataMaster Pro report business relationship between the mutual fund advisor and company.

¹¹ Excludes INVESCO funds, which are now part of AIM, but vote separately.

¹² Janus funds voted both "for" and "against" this proposal, but it appears that the majority of shares were voted "for".

¹³ T. Rowe Price's index funds, which appear to hold the majority of shares, voted "against" this proposal. Other T. Rowe Price funds voted "for" this proposal.

Company Profiles

Shareholder Proposals

Allergan

CSX

Delta

Kohl's

Lucent

PeopleSoft

Raytheon

Sprint

Management Proposals

Bear Stearns

Broadcom

Delphi

Union Pacific

Allergan Inc.

Meeting Date: 4/28/04

Item # 3: Expense Stock Options

Votes "FOR" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting FOR

American Century

American Funds

Franklin-Templeton

Vanguard

Mutual Fund Families Voting AGAINST

AIM

Fidelity

Janus

Putnam

T. Rowe Price

Allergan, Inc.

David E. I. Pyott
Chairman of the Board, President and Chief Executive Officer

2003 Compensation¹⁴

Salary	\$1,069,231
Bonus	\$1,075,000
Other ¹⁵	\$48,747
Option Grants ¹⁶	<u>\$8,720,838</u>
2003 Total	\$10,913,816

At pharmaceutical company Allergan, Inc., executives disproportionately benefit from stock options. In 2003, the top five most highly paid Allergan executives received 22.7 percent of all stock options granted to employees. Like at many companies, stock options make up the biggest part of Allergan CEO David Pyott's total compensation. In 2003, Mr. Pyott alone received 13.6 percent of all grants to employees. He also exercised \$6.6 million in stock options from previous years' grants, and as of December 31, 2003 held over \$33 million in unexercised in-the-money stock options.¹⁷

Allergan executives received these generous option grants in 2003 after a period of underperformance. *Business Week* ranked Allergan 446 in the S&P 500, and 15 out of 16 in the pharmaceuticals and biotech industry. *Business Week* graded Allergan an "F" for 1-year and 3-year profit growth, net margin, and return on equity.¹⁸ Independent proxy voting consultant Glass Lewis & Co. gave Allergan an "F" for pay-for-performance, noting that Allergan "paid more than its peers, but performed worse than its peers."¹⁹

Many investors believe that not expensing stock options has led to their overuse in executive pay. Total potential dilution from stock options at Allergan is 19 percent compared to a peer group average of 17.5 percent.²⁰ No wonder at Allergan's April 28, 2004 annual meeting, shareholders approved a proposal to require stock option expensing by 62 percent of votes cast. Keeping stock options off the books has also artificially boosted Allergan's profit reports, thereby further contributing to high executive pay. Had Allergan expensed in 2003, its net earnings would have been reduced by an additional \$36.4 million – representing a 69 percent increase in net losses.²¹

¹⁴ Allergan, Inc. Proxy Statement filed March 17, 2004.

¹⁵ Sum total of "Other Annual Compensation" and "All Other Compensation" including country club dues, financial planning services, gasoline and car allowances, life insurance, and above-market interest on deferred compensation.

¹⁶ Grant date present value based on the Black-Scholes model of option valuation.

¹⁷ Allergan, Inc. Proxy Statement filed March 17, 2004.

¹⁸ "S&P 500 Performance Ranking", *Business Week*, April 5, 2004.

¹⁹ Glass, Lewis & Co. Proxy Paper, April 14, 2004

²⁰ Investor Responsibility Research Center, April 8, 2004.

²¹ Allergan, Inc. 10-K filed March 5, 2004.

CSX Corp.

Meeting Date: 5/5/04

Item # 5: Limit Golden Parachutes

Votes "FOR" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting FOR

American Century

T. Rowe Price

Vanguard

Mutual Fund Families Voting AGAINST

Fidelity

Oppenheimer Funds

CSX Corp.

Michael J. Ward
Chairman of the Board, President and Chief Executive Officer

2003 Compensation²²

Salary	\$808,333
Other ²³	\$182,732
Option Grants ²⁴	<u>\$3,572,000</u>
2003 Total	\$4,563,065

Railroad company CSX Corp. has a history of lavish sendoffs for senior executives. Former CSX CEO John Snow received a lump-sum \$68.9 million payment when he left to become U.S. Treasury Secretary in 2003. This included \$33 million in lieu of future pension payments that the company valued at \$2.9 million a year -- more than Snow's \$2.1 million salary and bonus during his final year on the job. In computing Snow's pension, CSX credited Snow with 19 unearned years of service and included 250,000 shares of restricted stock which would not have vested had the compensation committee not approved accelerated vesting the previous year.²⁵

Current CSX CEO Michael Ward also stands to receive a generous golden parachute in the event of his termination. Under a five-year employment agreement signed in 2001, if Mr. Ward is terminated other than for cause, he is entitled to the salary and one-half of the target bonus otherwise payable for the balance of the agreement. CSX will also remove restrictions on a portion of the 165,000 shares of restricted stock he was granted in 2001.²⁶

Business Week ranked CSX 447 in the S&P 500 and second to last in its industry for its poor performance. *Business Week* also gave the CSX an "F" on four performance measures (1-year total return, 1-year sales growth, 1-year profit growth and return on equity).²⁷ Likewise, independent proxy voting consultant Glass Lewis and Co. gave CSX a "D" in pay-for-performance, noting that CSX paid more than its peers, but performed worse than its peers.²⁸

Many shareholders are concerned that large golden parachutes can reward underperformance leading up to an executive's termination. Moreover, they are rarely justified in light of the significant compensation already awarded most executives. At CSX's May 5, 2004 annual shareholder meeting, 73 percent of votes cast were in favor of a proposal to require shareholder approval of golden parachutes.

²² CSX Corp. Proxy Statement filed March 31, 2004.

²³ Sum total of "Other Annual Compensation" and "All Other Compensation" including personal use of company aircraft and above-market earnings on deferred compensation.

²⁴ Grant date present value based on the Black-Scholes model of option valuation.

²⁵ David S. Hilzenrath, "CSX Gave Snow \$68.9 Million When He Left," *Washington Post*, March 25, 2003.

²⁶ CSX Corp. Proxy Statement filed March 31, 2004.

²⁷ "S&P 500 Performance Ranking", *Business Week*, April 5, 2004.

²⁸ Glass, Lewis & Co. Proxy Paper, April 3, 2004

Delta Air Lines, Inc.

Meeting Date: 4/23/04

Item # 5: Executive Pensions

Votes "FOR" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting FOR

American Century

Oppenheimer Funds

T. Rowe Price

Mutual Fund Families Voting AGAINST

American Funds

Fidelity

Franklin-Templeton

Vanguard

Delta Air Lines, Inc.

Leo F. Mullin
Former Chairman of the Board and Chief Executive Officer

2003 Compensation²⁹

Salary	\$639,313
LTIP Payouts	\$353,200
Other ³⁰	\$179,360
Option Grants ³¹	<u>\$1,892,000</u>
2003 Total	\$3,063,873

In 2002 while the airline industry was struggling with a sharp drop in business from the September 11 terrorist attacks, Delta Air Lines paid \$13.4 million (including tax payments) to set up a bankruptcy-proof trust to fund the retirement benefits of then-CEO Leo Mullin, who retired May 1, 2004. At the time, the company was hemorrhaging money, slashing jobs and seeking government assistance.³² All told, Delta paid \$45 million into pension trusts for 35 Delta executives.³³ Mr. Mullin's pension was based on 28.5 years of service even though his actual tenure was only 6.5 years.³⁴

These executive pension payments occurred at a time when Delta's pension plans for union employees -- which are only partially insured in the event of bankruptcy -- were underfunded, and after nonunion employees had been switched to less generous "cash balance" retirement plan. The ensuing controversy caused the company to discontinue its executive retirement plan and to withhold a final payment to the executive trusts.³⁵

Business Week ranked the company near the bottom (#485) of the S&P 500, and last in its industry for its poor performance. *Business Week* also gave Delta an "F" on eight performance measures (1-year total return, 3-year total return, 1-year sales growth, 3-year sales growth, 1-year profit growth, 3-year profit growth, net margin and return on equity).³⁶ Likewise, independent proxy voting consultant Glass Lewis and Co. gave Delta an "F" in pay-for-performance, noting that Delta paid about the same as its peers, but performed significantly worse than its peers.³⁷

Inflated retirement benefits for executives undermines shareholders' efforts to link pay to performance. For this reason, many favor requiring shareholder approval of these arrangements. At Delta's April 23, 2004 annual shareholder meeting, 53 percent of votes cast supported a proposal to seek shareholder approval for extraordinary retirement benefits for senior executives -- such as granting unearned years of service credit, accelerated vesting of rights under a benefit plan, or using bankruptcy-proof trusts to fund supplementary executive retirement plans.

²⁹ Delta Corp. Proxy Statement filed March 23, 2004.

³⁰ Sum total of "Other Annual Compensation" and "All Other Compensation" including tax and financial planning services, use of a company car, flight benefits, tax reimbursements, and a term life insurance savings plan.

³¹ Grant date present value based on the Black-Scholes model of option valuation.

³² Russell Grantham, "Delta's bonuses fail to stop execs' flight," *Atlanta Journal-Constitution*, April 16, 2004.

³³ Evan Perez, "Pressured by Union, Delta Cancels Payment to Special Pension Plan," *Wall Street Journal*, August 12, 2003.

³⁴ Delta Corp. Proxy Statement filed March 23, 2004.

³⁵ Evan Perez, "Pressured by Union, Delta Cancels Payment to Special Pension Plan," *Wall Street Journal*, August 12, 2003.

³⁶ "S&P 500 Performance Ranking", *Business Week*, April 5, 2004.

³⁷ Glass, Lewis & Co. Proxy Paper, March 30, 2004

Kohl's Corp.

Meeting Date: 4/28/04

Item # 3: Performance-based Pay

Votes "FOR" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting FOR

American Century

Janus

T. Rowe Price

Mutual Fund Families Voting AGAINST

AIM

American Funds

Fidelity

Franklin-Templeton

Putnam

Vanguard

Kohl's Corp.

R. Lawrence Montgomery
Chief Executive Officer

2003 Compensation³⁸

Salary	\$1,014,583
Other ³⁹	\$9,799
Option Grants ⁴⁰	<u>\$6,714,348</u>
2003 Total	\$7,738,730

In 2003, Kohl's Corp. paid CEO R. Lawrence Montgomery \$7.7 million in total compensation including the potential realizable value of his stock option grants, more than six times his 2002 pay.⁴¹ In addition, the department store CEO cashed out \$29.2 million by exercising stock options granted to him in previous years, catapulting him onto the *Corporate Library's* top 10 list of S&P 500 CEO stock option profits in 2003 and *Business Week's* list of the 20 highest paid CEO's in the nation in 2003.⁴² Even after this enormous stock option cash-out, Mr. Montgomery still has a total of \$53.4 million in unexercised, in-the-money options.⁴³

Kohl's board of directors chose to reward Mr. Montgomery in 2003 with a large option grant despite the fact that the Kohl's share price fell 15.4% for the year ending January 31, 2004, a period during which the S&P 500 Department Store Index jumped 36.4%.⁴⁴ In fact, the company's share price has lagged its peer group index for the one, two and three years ending January 31, 2004. As a result, the department store chain fell to 203rd in *Business Week's* 2003 S&P 500 Performance Ranking, from 34th the prior year, using eight criteria of financial success. *Business Week* gave Kohl's an "F" grade for both one- and three-year total return.⁴⁵

Because stock option grants have no downside risk below the strike price, they encourage executives to adopt "shoot for the moon" business strategies that are designed to promote short-term stock price rather than long-term corporate value. Moreover, they can reward executives for temporary short-term results, even if this increase follows a long period of underperformance or is not sustainable. At Kohl's April 28, 2004 annual meeting, shareholders voted 25 percent of the votes cast in favor of granting actual shares of stock for meeting performance benchmarks, and to require that executives hold those shares for as long as they remain company executives.

³⁸ Kohl's Corporation Proxy Statement filed March 30, 2004.

³⁹ "All Other Compensation," including contributions to defined contribution plan and payments during fiscal 2002 under the Company's life insurance plan.

⁴⁰ Potential realizable value at assumed 5 percent annual rate of stock price appreciation.

⁴¹ Kohl's Corporation Proxy Statement filed March 30, 2004.

⁴² Hodgson, Paul, *The Corporate Library's CEO Pay Survey: CEO Pay 2003*, *The Corporate Library*, July 2004. Lavelle, Louis, "Executive Pay", *Business Week*, April 19, 2004. *Business Week* calculates executive pay based on options exercised, not granted, during the year.

⁴³ Kohl's Corporation Proxy Statement filed March 30, 2004.

⁴⁴ Calculations based on data disclosed in Kohl's Proxy Statement filed March 30, 2004.

⁴⁵ "S&P 500 Performance Ranking", *Business Week*, April 5, 2004.

Lucent Technologies Inc.

Meeting Date: 2/18/04

Item # 5: Golden Parachutes

Votes "FOR" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting FOR

American Century

T. Rowe Price

Vanguard

Mutual Fund Families Voting AGAINST

AIM

Fidelity

Franklin-Templeton

Oppenheimer Funds

Lucent Technologies Inc.

Patricia F. Russo
Chair of the Board and Chief Executive Officer

2003 Compensation⁴⁶

Salary	\$1,200,000
Bonus	\$3,245,333
Other ⁴⁷	\$41,209
Option Grants ⁴⁸	<u>\$2,140,000</u>
2003 Total	\$6,626,542

If telecommunications manufacturer Lucent Technologies CEO Patricia Russo is terminated without cause, she is entitled to immediate vesting of 1,220,000 stock options and 550,000 restricted shares, as well as two years' salary plus target bonus and continued benefit coverage and equity vesting for two years. She is also entitled to a tax gross up on her golden parachute. In total, Ms. Russo's severance benefits are worth an estimated \$10 million or more, at a time when the company is slashing retiree benefits for ordinary workers.⁴⁹

In 2002, her first year on the job, Ms. Russo made \$38 million while shareholders saw their investment plummet by 75 percent. Ms. Russo was featured in *Fortune* magazine's article entitled "Have They No Shame?" on CEOs whose performance "stank" while they "got paid more than ever."⁵⁰ This year, Lucent topped the *Wall Street Journal's* list of the worst 5-year performers.⁵¹ *Business Week* ranked Lucent 473 in the S&P 500 and 30th of 35th in its industry for its poor performance. *Business Week* also gave Lucent an "F" on seven performance measures (3-year total return, 1-year sales growth, 3-year sales growth, 1-year profit growth, 3-year profit growth, net margin and return on equity).⁵²

Requiring shareholder approval of executives' employment agreements is one way that golden parachutes can be limited. Moreover, excessive severance benefits can dramatically increase the cost of terminating an under-performing CEO, and reward the CEO for poor performance leading up to his or her termination. For this reason, investors strongly favor limiting golden parachutes. At Lucent's February 18, 2004 annual shareholder meeting, 67 percent of votes cast were in favor of a proposal to require shareholder approval of golden parachutes.

⁴⁶ Lucent Corp. Proxy Statement filed December 23, 2003.

⁴⁷ Sum total of "Other Annual Compensation" and "All Other Compensation" including above-market interest on deferred compensation, tax reimbursements, and company contributions to a savings plan.

⁴⁸ Grant date present value based on the Black-Scholes model of option valuation.

⁴⁹ Employment Agreement between Lucent Technologies and Patricia F. Russo, dated February 14, 2002; Lucent Corp. Proxy Statement filed December 23, 2003. Jay Hancock, "Big payouts for bosses draw stockholder ire," *The Baltimore Sun*, February 25, 2004.

⁵⁰ Jerry Useem, "Have They No Shame?; Their performance stank last year, yet most CEOs got paid more than ever," *Fortune*, April 28, 2003.

⁵¹ "Shareholder Scoreboard; The Best and Worst Performers of the WSJ 1000," *Wall Street Journal*, March 8, 2004.

⁵² "S&P 500 Performance Ranking", *Business Week*, April 5, 2004.

Peoplesoft, Inc.

Meeting Date: 3/25/04

Item # 3: Expense Stock Options

Votes "FOR" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting FOR

American Century

American Funds

Franklin-Templeton

Janus

Oppenheimer Funds

Vanguard

Mutual Fund Families Voting AGAINST

AIM

Fidelity

Putnam

T. Rowe Price

PeopleSoft, Inc.

Craig A. Conway
President and Chief Executive Officer

2003 Compensation⁵³

Salary	\$1,000,000
Bonus	\$2,325,000
Option Grants ⁵⁴	<u>\$16,940,064</u>
2003 Total	\$20,265,064

A hostile takeover bid by the Oracle Corporation may have executives at the enterprise software company PeopleSoft, Inc. feeling nervous. At least PeopleSoft CEO Craig Conway doesn't have to worry about his severance. In the event of a change in control, Conway's employment contract promises a golden parachute equal to two years' salary and bonus, plus immediate vesting of all stock options and restricted stock. In 2003, Conway took home over 10 percent of all stock option grants to PeopleSoft employees, and by year-end he held over \$29 million in-the-money stock options.⁵⁵

Oracle's buyout offer may have been triggered by PeopleSoft's recent poor performance. *Business Week* ranked PeopleSoft 411 in the S&P 500, and 20 out of 28 in the software and services industry. *Business Week* graded PeopleSoft an "F" for 3-year total return, 1-year profit growth, and return on equity.⁵⁶ Independent proxy voting consultant Glass Lewis & Co. gave PeopleSoft an "F" for pay-for-performance, noting that "[t]he Company's compensation to its CEO was significantly more than the median" for comparable companies.⁵⁷

In response to shareholder concern, PeopleSoft has recently taken steps to reduce its total potential dilution from stock options, which reached 35.5 percent compared to its peer group median of 25.1 percent.⁵⁸ PeopleSoft also promised to add performance-based requirements to its executives' future equity compensation awards.⁵⁹ Shareholders want PeopleSoft to go further: at the March 25, 2004 annual meeting a majority of votes were cast in favor of stock option expensing. Had PeopleSoft expensed stock options in 2003, its \$85 million net profit would have turned into a \$75 million net loss.⁶⁰

⁵³PeopleSoft, Inc. Proxy Statement filed February 23, 2004.

⁵⁴Potential realizable value at assumed 5 percent annual rate of stock price appreciation.

⁵⁵PeopleSoft, Inc. Proxy Statement filed February 23, 2004.

⁵⁶"S&P 500 Performance Ranking", *Business Week*, April 5, 2004.

⁵⁷Glass, Lewis & Co. Proxy Paper, March 16, 2004

⁵⁸Investor Responsibility Research Center

⁵⁹PeopleSoft, Inc. Proxy Statement filed February 23, 2004

⁶⁰PeopleSoft, Inc. 10-K filed March 4, 2004

Raytheon Co.

Meeting Date: 5/5/04

Item # 7: Expense Stock Options

Votes "FOR" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting FOR

American Century

American Funds

Franklin-Templeton

Oppenheimer Funds

Vanguard

Mutual Fund Families Voting AGAINST

AIM

Fidelity

Putnam

T. Rowe Price

Raytheon Co.

William H. Swanson
Chairman of the Board and Chief Executive Officer

2003 Compensation⁶¹

Salary	\$858,090
Bonus	\$1,355,000
Restricted Stock	\$3,939,000
Other ⁶²	\$317,814
Option Grants ⁶³	<u>\$2,941,516</u>
2003 Total	\$9,411,420

Defense electronics company Raytheon paid its newly-promoted CEO, William H. Swanson, \$9.4 million in total compensation for 2003. Mr. Swanson has another \$2,440,155 in unexercised stock options from his previous years as a top Raytheon executive, as well as \$1 million in interest-free loans.⁶⁴ Compared to its competitors, Raytheon is a prolific grantor of stock options: Raytheon's total potential dilution from stock options is 15.1 percent compared to its peer group median of 12.4 percent.⁶⁵

Even though Raytheon argues that the compensation of its CEO and other senior executives is based on "performance and comparability," the company's performance has not been as stunning as its CEO's compensation package. *Business Week* ranked Raytheon 321 in the S&P 500, and 29 out of 37 in the capital goods industry. *Business Week* graded Raytheon with an "F" for 1-year total return and profit growth.⁶⁶

Raytheon does not recognize the cost of its stock option grants as an expense. This failure to expense can promote the excessive use of stock options in a company's executive compensation. Had Raytheon expensed in 2003, its net earnings would have been reduced by \$68 million – representing a 19% decrease in net earnings.⁶⁷ No wonder that at Raytheon's May 5, 2004 annual meeting, 66.5 percent of voting shareholders approved a proposal to require stock option expensing.

⁶¹ Raytheon Co. Proxy Statement Filed May 5, 2004.

⁶² Sum total of "Other Annual Compensation" and "All Other Compensation" including reimbursements for tax payments, personal use of company aircraft, personal use of company automobiles, life insurance, excess executive liability insurance, ancillary expenses, and interest-free loans.

⁶³ Grant date present value based on the Black-Scholes model of option valuation.

⁶⁴ Raytheon Co. Proxy Statement filed May 5, 2004.

⁶⁵ Investor Responsibility Research Center, April 22, 2004.

⁶⁶ "S&P 500 Performance Ranking," *Business Week*, April 5, 2004.

⁶⁷ Raytheon Co. 10-K filed March 15, 2004.

Sprint Corp.

Meeting Date: 4/20/04

Item # 3: Performance-based Pay

Votes "FOR" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting FOR

AIM

American Century

Franklin-Templeton

Janus

Oppenheimer Funds

T. Rowe Price

Mutual Fund Families Voting AGAINST

American Funds

Fidelity

Putnam

Vanguard

Sprint Corp.

Gary D. Forsee
Chairman and Chief Executive Officer
Sprint Corp. FON

2003 Compensation⁶⁸

Salary	\$813,410
Bonus	\$2,532,206
Other ⁶⁹	\$255,591
Restricted Stock	\$12,844,751
Option Grants ⁷⁰	<u>\$10,691,344</u>
2003 Total	\$27,137,302

In 2003, *Business Week* lambasted the compensation committee of Sprint's board of directors for granting excessive pay to executives and abusing stock options. "The compensation panel didn't seem to know how to say no to management," wrote *Business Week*. "It repriced executive options and allowed execs to cash in options worth hundreds of millions of dollars when shareholders approved a WorldCom merger -- even though regulators rejected the deal."⁷¹

Unfortunately for shareholders, Sprint continues to award outrageous pay packages to executives even as the company's financial performance and share price languish. In 2003, the global telecommunications company paid its new CEO, Gary D. Forsee, a staggering \$27.1 million in total compensation, including stock option grants worth \$10.7 million.⁷² Mr. Forsee received this generous pay package despite the fact that *Business Week* ranked Sprint's performance 418th out of the S&P 500 using eight criteria of financial success. Sprint received "F" grades from *Business Week* for return on equity, one- and three-year profit growth and one- and three-year sales growth.⁷³

At Sprint's April 20, 2004 annual meeting, shareholders voted on a policy to require that all future stock options granted to senior executives be performance-based. A stock option is performance-based if the option exercise price is indexed so that the options have value only to the extent that the company's stock price performance exceeds its peer group performance level. This performance-based pay proposal received the support of 32 percent of the votes cast.

⁶⁸ Sprint Corp. Proxy Statement filed March 16, 2004.

⁶⁹ Sum total of "Other Annual Compensation and "All Other Compensation," including reimbursement of legal and professional fees paid by Mr. Forsee in connection with the negotiation of his employment contract.

⁷⁰ Potential realizable value at assumed 5 percent annual rate of stock price appreciation.

⁷¹ Lavelle, Louis, "Sprint's Board Needs A Good Sweeping, Too," *Business Week*, February 23, 2003.

⁷² Sprint Corp. Proxy Statement filed March 16, 2004.

⁷³ "S&P 500 Performance Ranking," *Business Week*, April 5, 2004.

Bear Stearns Co.

Meeting Date: 3/31/04

Item # 2: Capital Accumulation Plan

Votes "AGAINST" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting AGAINST

AIM

American Century

Janus

Oppenheimer Funds

T. Rowe Price

Vanguard

Mutual Fund Families Voting FOR

Fidelity

Franklin-Templeton

Putnam

Bear Stearns Co.

James E. Cayne
Chairman and Chief Executive Officer

2003 Compensation⁷⁴

Salary	\$200,000
Bonus	\$11,009,432
Restricted Stock	\$10,419,633
Option Grants ⁷⁵	\$5,397,317
Other ⁷⁶	<u>\$12,296,347</u>
2003 Total	\$39,322,729

A study of executive pay commissioned by the *New York Times* put Bear Stearns CEO James Cayne near the top of the list of career earners (Mr. Cayne collected \$247 million over ten years).⁷⁷ Mr. Cayne also served on the New York Stock Exchange compensation committee that approved Chairman Richard Grasso's lavish deferred compensation package.⁷⁸ Like Mr. Grasso, Bear Stearns' CEO has accumulated a sizable nest egg for retirement. Mr. Cayne has amassed over \$85 million in deferred stock in Bear Stearns' Capital Accumulation Plan. He also received over \$12 million in preferential earnings in addition to cash dividends on these shares.⁷⁹

At the March 31, 2004 annual shareholder meeting, Bear Stearns asked shareholders to approve its Capital Accumulation Plan. Under the plan, each year Bear Stearns may award stock grants up to 15 percent of the total outstanding shares to executives. This means that during the life of the plan, stock exceeding 150 percent of today's total outstanding shares may be transferred to executives. Combined with Bear Stearns' other equity compensation plans, total potential dilution is a massive 229.8 percent compared to a peer group median of 14.2 percent.⁸⁰

Past awards to executives under the Capital Accumulation Plan have not been modest. As of November 30, 2003, the top five executives held a combined \$409 million in shares under the plan. During 2003, Bear Stearns recognized from this plan an expense of \$295 million in grants and \$193 million in preferential earnings to executives, the equivalent of 42 percent of Bear Stearns 2003 net income.⁸¹ Not surprisingly, 41 percent of votes were cast against this plan, and independent proxy advisor Institutional Shareholder Services recommended a "no" vote.

⁷⁴ Bear Stearns Corp. Proxy Statement filed February 27, 2004.

⁷⁵ Grant date present value based on the Black-Scholes model of option valuation.

⁷⁶ "All Other Compensation" includes preferential earnings on the Capital Accumulation Plan.

⁷⁷ Patrick McGeehan, "What Pays a Legend Most? In Many Cases, It's the Options," *The New York Times*, April 4, 2004.

⁷⁸ Landon Thomas Jr., "A Pay Package That Fat Cats Call Excessive," *The New York Times*, August 29, 2003.

⁷⁹ Bear Stearns Corp. Proxy Statement filed February 27, 2004.

⁸⁰ Investor Responsibility Research Center, March 12, 2004.

⁸¹ Bear Stearns 2003 Annual Report.

Broadcom Corp.

Meeting Date: 04/29/04

Item # 2: Stock Incentive Plan

Votes "AGAINST" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting AGAINST

AIM

American Century

Fidelity

Franklin-Templeton

Janus

Oppenheimer Funds

Putnam

T. Rowe Price

Vanguard

Mutual Fund Families Voting FOR

None

Broadcom Corp.

Alan E. Ross
President and Chief Executive Officer

2003 Compensation⁸²

Salary	\$522,000
Bonus	\$250,000
Option Grants ⁸³	\$3,256,102
Other ⁸⁴	<u>\$173,729</u>
2003 Total	\$4,201,102

In describing the pay practices of this broadband communications and networking company, the *New York Times* observed that “just when you thought you had seen the most outrageous transfer of shareholder wealth to executives through stock options, along comes a company that tops them all.”⁸⁵ Last year Broadcom CEO Alan Ross exercised \$2.1 million in stock options, and held \$8 million in unexercised in-the-money stock options as of December 31, 2003. In 2001 and again in 2003 the company had allowed employees to exchange their underwater stock options.⁸⁶

Mr. Ross chairs the Board’s Option Committee that is responsible for administering the company’s stock option plans.⁸⁷ At the April 29, 2004 annual shareholder meeting, management asked shareholders to renew the company’s Stock Incentive Plan. The plan explicitly permits stock option repricing, and adds 12 million shares, increasing Broadcom’s total potential dilution to 92.4 percent compared to a peer group median of 25.1 percent.⁸⁸ Had Broadcom expensed stock options in 2003, its net losses would have increased by \$448 million, or 47 percent.⁸⁹

Independent proxy voting consultants Institutional Shareholder Services and Glass Lewis & Co. opposed the plan, with Glass Lewis noting that it had “failed miserably and is among the most expensive and liberal plans we have reviewed.”⁹⁰ While an overwhelming majority (89 percent) of Class A shares voted against the plan, it passed over the objection of outside shareholders because the company's dual class stock structure gives insiders disproportionate voting power.⁹¹

⁸² Broadcom Corp. Proxy Statement filed March 29, 2004.

⁸³ Potential realizable value at assumed 5 percent annual rate of stock price appreciation.

⁸⁴ “Other Annual Compensation,” including reimbursement for Ross's use of his private airplane, housing and travel expenses, tax reimbursements, and income realized for life insurance premiums.

⁸⁵ Gretchen Morgenson, “Bubble Lives on at Broadcom, Where Options Still Rain Down,” *The New York Times*, April 18, 2004.

⁸⁶ Broadcom Corp. Proxy Statement filed March 29, 2004.

⁸⁷ Broadcom Corp. Proxy Statement filed March 29, 2004.

⁸⁸ Investor Responsibility Research Center, April 15, 2004.

⁸⁹ Broadcom Corp. 10-K filed March 15, 2004.

⁹⁰ Glass Lewis & Co. Proxy Paper, April 8, 2004.

⁹¹ Broadcom Corp. 10-Q filed August 9, 2004.

Delphi Corp.

Meeting Date: 5/6/04

Item # 4: Long-Term Incentive Plan

Votes "AGAINST" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting AGAINST

American Century

American Funds

Fidelity

Putnam

Vanguard

Mutual Fund Families Voting FOR

AIM

Franklin-Templeton

Oppenheimer Funds

T. Rowe Price

Delphi Corp.

J.T. Battenberg III
Chairman of the Board, President and Chief Executive Officer

2003 Compensation⁹²

Salary	\$1,675,000
Other ⁹³	\$159,690
Restricted Stock	\$1,213,920
LTIP	\$732,000
Option Grants ⁹⁴	<u>\$2,178,528</u>
2003 Total	\$5,959,138

At auto parts manufacturer Delphi, executives disproportionately benefit from equity compensation. In 2003, the top five most highly paid Delphi executives received 17.5 percent of all stock options granted to employees. Stock options are the single biggest component of Delphi CEO J.T. Battenberg's total compensation, and Mr. Battenberg alone received 7.8 percent of all grants to employees in 2003. At the end of the year, Mr. Battenberg held \$1.7 million in unexercised in-the-money stock options.⁹⁵

Business Week ranked the company near the bottom (#435) of the S&P 500 and seventh out of nine in its industry for poor performance. *Business Week* also gave the Delphi an "F" on five performance measures (3-year total return, 1-year profit growth, 3-year profit growth, net margin, and return on equity).⁹⁶ Likewise, independent proxy voting consultant Glass Lewis and Co. gave Delphi an "F" in pay-for-performance, noting that Delphi paid more than its peers, but performed worse than its peers.⁹⁷

At Delphi's May 6, 2004 annual shareholder meeting, 34.6 percent of votes cast opposed management's proposal to increase the number of shares available under the company's Employee Long-Term Incentive and Share Award Plan. The proposal authorized the issuance of 36.5 million shares for equity compensation, increasing Delphi's total potential dilution to 22.7 percent compared to its peer group median of 14.5 percent.⁹⁸ Had Delphi expensed stock options, its 2003 net losses would have increased by \$17 million, or 30 percent.⁹⁹

⁹² Delphi Corp. Proxy Statement filed March 26, 2004.

⁹³ Sum total of "Other Annual Compensation" and "All Other Compensation" including use of company transportation, matching contributions under the stock purchase plan, and life insurance premiums.

⁹⁴ Grant date present value based on the Black-Scholes model of option valuation.

⁹⁵ Delphi Corp. Proxy Statement filed March 26, 2004.

⁹⁶ "S&P 500 Performance Ranking", *Business Week*, April 5, 2004.

⁹⁷ Glass Lewis & Co. Proxy Paper, April 9, 2004.

⁹⁸ Investor Responsibility Research Center, April 26, 2004.

⁹⁹ Delphi 10-K filed April 1, 2004.

Union Pacific Corp.

Meeting Date: 4/16/04

Item # 2: Stock Incentive Plan

Votes "AGAINST" This Proposal Support Limiting Excessive Executive Pay

Mutual Fund Families Voting AGAINST

American Century

Fidelity

Oppenheimer Funds

Vanguard

Mutual Fund Families Voting FOR

AIM

American Funds

Franklin-Templeton

Janus

Putnam

T. Rowe Price

Union Pacific Corp.

Richard K. Davidson
Chairman and Chief Executive Officer

2003 Compensation¹⁰⁰

Salary	\$1,258,333
Other ¹⁰¹	\$301,115
Restricted Stock	\$4,500,000
LTIP	\$7,999,113
Option Grants ¹⁰²	<u>\$4,646,395</u>
2003 Total	\$18,704,956

In 2001, the Union Pacific Board approved a long-term incentive pay plan whereby executives would receive stock units and cash if the company's stock traded above \$70 a share for 20 days or the company's three-year earnings totaled at least \$13.50 a share. To help meet the second of these goals, the compensation committee included in "earnings" the proceeds from the company's initial public offering of its Overnite unit. As a result of this creative accounting, Union Pacific CEO Richard Davidson was able to collect 20,000 shares and \$1.4 million in cash.¹⁰³

The lion's share of Union Pacific's stock options is awarded to top executives. Mr. Davidson alone received 13.6 percent of all grants to employees in 2003. He also exercised \$1 million in stock options from previous years' grants, and as of December 31, 2003 held over \$34 million in unexercised in-the-money stock options.¹⁰⁴ Proxy voting consultant Glass Lewis & Co. gave Union Pacific an "D" in pay-for-performance, noting that Union Pacific paid significantly more than its peers, but performed about the same as its peers.¹⁰⁵

At Union Pacific's April 16, 2004 annual shareholder meeting, 32.5 percent of votes cast opposed management's proposed Stock Incentive Plan. The proposal authorized the issuance of 21 million shares for equity compensation, increasing Union Pacific's total potential dilution to 18.7 percent compared to a peer group median of 12.4 percent. The company does not disclose its performance goals or holding period guidelines, and the plan includes a provision for immediate vesting in the event of a change of control.¹⁰⁶

¹⁰⁰ Union Pacific Corp. Proxy Statement filed March 10, 2004.

¹⁰¹ Sum total of "Other Annual Compensation" and "All Other Compensation" including reimbursements for tax on supplemental pension and thrift plans, above-market interest paid on deferred compensation, use of company transportation, tax and financial counseling, matching contributions under the stock purchase plan, and life insurance premiums.

¹⁰² Grant date present value based on the Black-Scholes model of option valuation.

¹⁰³ Gretchen Morgenson, "Pay Package at Risk? Quick, Get Creative," *The New York Times*, November 23, 2003.

¹⁰⁴ Union Pacific Corp. Proxy Statement filed March 10, 2004.

¹⁰⁵ Glass Lewis & Co. Proxy Paper, April 5, 2004.

¹⁰⁶ Investor Responsibility Research Center, April 15, 2004