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Fidelity Releases Revised Proxy Voting Guidelines

In March, Fidelity released its revised proxy voting guidelines,¹ which contain several significant updates to its prior guidelines that are effective immediately. While the revised guidelines also affect proposals related to the election of directors, changes in corporate control, and shareholder rights, this letter focuses primarily on those changes that impact Fidelity's votes on compensation proposals. A summary of the changes discussed in this letter is listed below:

- The “economic” guideline for determining equity award plan votes is now based on a company's three-year average burn rate and not the dilutive effect of the proposed plan, as has historically been the case;
- On Say-on-Pay proposals, Fidelity will (1) support annual advisory votes on executive compensation, (2) generally vote for proposals to approve executive compensation unless such compensation is misaligned with shareholder interests, and (3) generally vote against proposals to approve golden parachutes.²

Equity Plan Voting Guidelines: Burn Rate Guideline

The most significant change to the guidelines is the shift in focus from an equity award plan's dilutive effect to the company's three-year average burn rate as the primary determinant of Fidelity's vote. Specifically, the guidelines provide that Fidelity will generally vote against equity award plans or amendments to authorize additional shares if:

1. The company's three-year average burn rate is greater than:
 - 1.5% for a Large-Capitalization Company;³
 - 2.5% for a Small-Capitalization Company; or
 - 3.5% for a Micro-Capitalization Company; and
2. There are no circumstances specific to the company that would lead Fidelity to conclude that the burn rate is acceptable.

¹ Full text is available at: <http://personal.fidelity.com/myfidelity/InsideFidelity/InvestExpertise/governance.shtml>

² A “golden parachute” is defined as “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 payment of cash 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.”

³ A Large-Capitalization Company is included in the Russell 1000 Index, a Small-Capitalization Company is not included in the Russell 1000 Index and is not a Micro-Capitalization Company, and a Micro-Capitalization Company has a market capitalization under U.S. \$300 million.

Similar to the application of its prior dilution guidelines, Fidelity will consider additional factors that may help put a company's excessive burn rate in context and still allow for a positive vote (i.e., the burn rate caps are not absolute). However, there is no indication that Fidelity will account for differences in typical burn rates by industry. Additionally, it does not appear that Fidelity will use an "option-equivalent" burn rate, which would apply a multiplier to full-value share awards and is used, for example, by ISS in issuing its voting recommendations.

The shift in focus to a company's historic grant practice may affect the timing of equity plan proposals if a company does not have a regular annual grant practice. It may also have negative implications for companies that make significant special awards that temporarily increase their burn rates. Such awards, however, would also have had potentially negative consequences for new share requests under the prior dilution guidelines. Furthermore, because the "simple" burn rate calculation does not account for the value difference between options and full-value share awards, it creates an incentive for companies to use full-value share awards rather than options, as options use more shares for the same compensation value. It also remains to be seen whether Fidelity will account in any other way for the size of an equity plan proposal, such as the number of years the corresponding share pool will likely be available for grants at the company's current burn rate.

It is important to note that for Fidelity Funds sub-advised by Geode Capital Management LLC ("Geode"), which discloses its own set of proxy voting guidelines, voting for equity plan proposals will continue to focus on the dilutive effect of the plan (i.e., the dilutive effect of the plan may not be greater than 10%, or 15% for companies with a smaller market capitalization).

Additional Equity Plan Voting Guidelines

In 2010, Fidelity expanded its guidelines to vote against equity award plans that include an evergreen provision⁴ or that provide for acceleration of equity award vesting without an actual change in control occurring (similar to the ISS "liberal change in control" definition).

The revised guidelines continue to require a restriction period of no less than three years for time-based share awards and a performance period of no less than one year for performance-based awards. Shorter periods are permitted for up to 5% of a plan's shares for Large-Capitalization companies (10% for Small- or Micro-Capitalization companies).⁵ We presume that Fidelity continues to allow for accelerated vesting, at the compensation committee's discretion, in the event of the death, disability or retirement of a plan participant or a change in control. Language to this effect in the 2009 guidelines was removed in 2010. Fidelity has also provided clarification in the past that it allows for pro-rata vesting over the three-year restriction period for time-based share awards.

In prior guidelines, Fidelity disclosed that it would generally vote against equity award plans that could be materially altered without shareholder approval or if awards to non-employee directors

⁴ An "evergreen provision" is defined as "a feature which provides for an automatic increase in the shares available for grant under an equity award plan on a regular basis."

⁵ This "de minimis" exception is also present in the proxy voting guidelines for funds sub-advised by Geode.

were subject to management discretion. Such language is no longer included in Fidelity's proxy voting guidelines pertaining to equity award plans.

Say-on-Pay Proposals

Fidelity will generally vote for proposals to approve executive compensation, provided that such compensation is not misaligned with shareholder interests. In determining any misalignment, Fidelity will take into account, among other factors, whether (1) a company has an independent compensation committee, (2) the compensation committee engaged independent compensation consultants, (3) the compensation committee lapsed or waived equity vesting restrictions, and (4) the company adopted or extended a golden parachute without shareholder approval. Also, Fidelity generally supports annual advisory votes on executive compensation, which is consistent with shareholder preferences based on votes to date.

Finally, Fidelity's guidelines state it will generally vote against proposals to approve golden parachutes. This may have negative implications for companies seeking to comply with the requirement under the Dodd-Frank Act regarding the Say-on-Golden Parachute advisory vote to be made in connection with change in control transactions, unless there are no excise tax gross-ups and the value of cash severance and accelerated equity is capped at three times salary and bonus.

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This letter is intended to alert compensation professionals about developments that may affect their companies and should not be relied on as providing specific company advice. General questions about the subjects in this letter may be directed to Claudio Schneider at 212-299-3703 (cgschneider@fwcook.com) or Wendy Hilburn at 212-299-3707 (wjhilburn@fwcook.com). Copies of this letter and other published materials are available on our website at www.fwcook.com.