

CARDINAL HEALTH INC

Form PRE 14A

September 14, 2005

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SCHEDULE 14A  
(RULE 14A-101)  
INFORMATION REQUIRED IN PROXY STATEMENT  
SCHEDULE 14A INFORMATION  
PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
(AMENDMENT NO. )

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement  CONFIDENTIAL, FOR USE OF THE COMMISSION ONLY (AS PERMITTED BY RULE 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12.

CARDINAL HEALTH, INC.  
(NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

N/A  
(NAME OF PERSON(S) FILING PROXY STATEMENT, IF OTHER THAN THE REGISTRANT)

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- (1) Amount Previously Paid:
  - (2) Form, Schedule or Registration Statement No.:
  - (3) Filing Party:
  - (4) Date Filed:
-

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**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS  
TO BE HELD NOVEMBER 2, 2005**

Notice is hereby given that the Annual Meeting of Shareholders of Cardinal Health, Inc., an Ohio corporation (the Company), will be held at the Company's corporate offices at 7000 Cardinal Place, Dublin, Ohio, on November 2, 2005 at 2:00 p.m., local time, for the following purposes:

1. To elect five Directors, each to serve for a term of three years and until his or her successor is duly elected and qualified;
2. To vote on a proposal to adopt the Cardinal Health, Inc. 2005 Long-Term Incentive Plan;
3. To vote on a proposal to adopt amendments to the Company's Restated Code of Regulations to provide for the annual election of Directors; and
4. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

**The Board of Directors recommends that you vote FOR the election of the five Directors listed in Proposal 1 and FOR Proposals 2 and 3.**

Only shareholders of record at the close of business on September 9, 2005 are entitled to notice of and to vote at the meeting or any adjournment or postponement thereof.

**Only persons with an admission ticket or proof of share ownership will be admitted to the Annual Meeting. If you are a shareholder of record, your admission ticket is attached to your proxy card. You will need to bring it with you to the Annual Meeting, together with proper identification. If your shares are not registered in your name, you must bring proof of share ownership (such as a recent bank or brokerage firm account statement, together with proper identification) in order to be admitted to the Annual Meeting.**

By Order of the Board of Directors.

BRENDAN A. FORD, *Secretary*

September 1, 2005

**Whether or not you expect to attend the Annual Meeting in person, you are urged to complete, date and sign the enclosed proxy and return it in the enclosed postage-paid envelope, or to vote by telephone or the Internet pursuant to instructions provided with the proxy.**

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**PROXY STATEMENT**

This Proxy Statement is being furnished in connection with the solicitation of proxies on behalf of the Board of Directors of Cardinal Health, Inc., an Ohio corporation ( Cardinal Health or the Company ), for use at the Annual Meeting of Shareholders of the Company (the Annual Meeting ) to be held on Wednesday, November 2, 2005, at the Company s corporate offices located at 7000 Cardinal Place, Dublin, Ohio 43017, at 2:00 p.m., local time, and at any adjournment or postponement thereof. This Proxy Statement and the accompanying proxy, together with the Company s Annual Report to Shareholders, which includes its Annual Report on Form 10-K for the fiscal year ended June 30, 2005, except for any exhibits thereto, are first being sent to shareholders of the Company on or about September , 2005. Exhibits will be provided to any shareholder upon request to the Company s Investor Relations department.

The close of business on September 9, 2005 has been fixed as the record date for the determination of shareholders of the Company entitled to notice of and to vote at the Annual Meeting. On that date, the Company had outstanding 426,835,457 common shares, without par value ( Common Shares ). Except as set forth below, holders of Common Shares at the record date are entitled to one vote per share for the election of Directors and upon all matters on which shareholders are entitled to vote.

The address of the Company s principal executive office is 7000 Cardinal Place, Dublin, Ohio 43017.

**ELECTION OF DIRECTORS**

The Company s Board of Directors currently consists of thirteen members, divided into three classes (two classes of five members each and one class of three members).

At the Annual Meeting, the Company s shareholders will be asked to vote for the election of the five nominees named below, each to serve for a term of three years and until his or her successor is duly elected and qualified. (See Proposal 1 below.) At the Annual Meeting, the Company s shareholders will be asked to vote on amendments to the Company s Restated Code of Regulations (the Code of Regulations ), to provide for the annual election of Directors beginning with the 2006 Annual Meeting of Shareholders (see Proposal 3 below).

Common Shares represented by proxies, unless otherwise specified, will be voted for the election of the five nominees. If, by reason of death or other unexpected occurrence, any one or more of the nominees should not be available for election, the proxies will be voted for the election of any substitute nominee(s) as the Board of Directors may propose. Proxies may not be voted at the Annual Meeting for more than five nominees.

Under Ohio law, if notice in writing is given by any shareholder entitled to vote at the Annual Meeting to the President, a Vice President or the Secretary of the Company, not less than 48 hours before the scheduled time of the meeting, that the shareholder desires the voting for election of Directors to be cumulative, and if an announcement of the request for cumulative voting is made at the beginning of the meeting by the Chairperson or Secretary, or by or on behalf of the shareholder giving such notice, each shareholder entitled to vote at the Annual Meeting will have the right to cumulate such voting power as he or she possesses at such election and to give one nominee a number of votes equal to the number of Directors to be elected multiplied by the number of shares he or she holds, or to distribute votes on the same basis among two or more nominees, as he or she sees fit. If voting for the election of Directors is cumulative, the persons named in the enclosed proxy intend to vote the shares represented thereby and by other proxies held by them so as to elect as many of the five nominees named below as possible.

Votes will be tabulated by or under the direction of inspectors of election, who will certify the results of the voting at the Annual Meeting. The five nominees receiving the greatest number of votes will be elected Directors. Abstentions and broker non-votes will not affect the results of the election.

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Set forth below is the following information regarding those persons nominated for election as Directors of the Company (each is currently a Director of the Company) and of those persons serving as Directors of the Company whose terms of office will continue after the Annual Meeting: their names, ages, principal occupations, and positions held during the past five years (unless otherwise stated, the positions listed have been held during the entire past five years); certain other board memberships (which are shown parenthetically); the year in which they first became a Director of the Company; and the year in which their term as a Director is scheduled to expire (information provided as of September 9, 2005). The Company has previously announced that Mr. Bing intends to resign from the Company's Board of Directors at the time of the Company's 2005 Annual Meeting of Shareholders.



**Table of Contents****Nominees for Election at the Annual Meeting**

<b>Name</b>	<b>Age</b>	<b>Principal Occupation/Past Experience</b>	<b>Director Since</b>	<b>Term Expires</b>
J. Michael Losh	59	Former Chief Financial Officer of the Company (on an interim basis), July 2004 to May 2005; Chairman of Metaldyne Corporation, an automotive parts manufacturer, October 2000 to April 2002; Chief Financial Officer of General Motors Corporation, an automobile manufacturer, 1994 to August 2000 (director of AMB Property Corporation, an industrial real estate owner and operator; Aon Corporation, an insurance brokerage, consulting and underwriting company; H.B. Fuller Company, a specialty chemicals and industrial adhesives manufacturer; Masco Corp., a manufacturer of home improvement and building products; Metaldyne Corporation; and TRW Automotive Holdings Corp., a supplier of automotive systems, modules and components).	1996	2005
John B. McCoy	62	Retired Chairman of Corillian Corporation, an online banking and software services company, June 2000 to January 2004; Chief Executive Officer of Bank One Corporation, a bank holding company, 1984 to December 1999 (director of SBC Communications, Inc., a telecommunications systems company; and ChoicePoint Inc., a provider of data management products and services.)	1987	2005
Michael D. O Halleran	55	Senior Executive Vice President of Aon Corporation, September 2004 to present; President and Chief Operating Officer of Aon Corporation, April 1999 to September 2004.	1999	2005
Jean G. Spaulding, M.D	58	Consultant, Duke University Health System, a non-profit academic health care system, January 2003 to present; Trustee, The Duke Endowment, a charitable trust, January 2002 to present; private medical practice in psychiatry, 1977 to present; Associate Clinical Professorships at Duke University Medical Center, a non-profit academic hospital, 1998 to present; Vice Chancellor for	2002	2005

Health Affairs, Duke University Health System, 1998 to 2002.

Matthew D. Walter	36	Chief Executive Officer of BoundTree Medical Products, Inc., a provider of medical equipment to the emergency medical market, November 2000 to present; Managing Partner of Talisman Capital, a private investment company, June 2000 to present; Vice President and General Manager of National PharmPak, Inc., a subsidiary of Cardinal Health, Inc., July 1996 to September 2000 (director of Bancinsurance Corporation, an insurance holding company). Mr. M. Walter is the son of Robert D. Walter, Chairman and Chief Executive Officer of the Company.	2002	2005
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**Table of Contents****Directors Whose Terms Will Continue after the Annual Meeting**

<b>Name</b>	<b>Age</b>	<b>Principal Occupation/Past Experience</b>	<b>Director Since</b>	<b>Term Expires</b>
John F. Finn	57	Chairman and Chief Executive Officer of Gardner, Inc., an outdoor power equipment distributor (director of J.P. Morgan Funds, a registered investment company).	1994	2006
John F. Havens	78	Director Emeritus and retired Chairman of Bank One Corporation.	1979	2006
David W. Raisbeck	55	Vice Chairman of Cargill, Incorporated, a marketer, processor and distributor of agricultural, food, financial and industrial products and services, November 1999 to present (director of Eastman Chemical Company, a plastics, chemicals and fibers manufacturer).	2002	2006
Robert D. Walter	60	Chairman and Chief Executive Officer of the Company (director of American Express Company, a travel, financial and network services company; and Viacom Inc., a media company). Mr. R. Walter is the father of Matthew D. Walter, a Director of the Company.	1971	2006
George H. Conrades	66	Executive Chairman, Akamai Technologies, Inc., an e-business infrastructure provider, April 2005 to present; Chairman and Chief Executive Officer of Akamai Technologies, Inc. (April 1999 to April 2005); Venture partner in Polaris Venture Partners, an early stage investment company, August 1998 to present (director of Akamai Technologies, Inc.; and Harley-Davidson, Inc., a motorcycle manufacturer).	1999	2007
Robert L. Gerbig	60	Retired Chairman and Chief Executive Officer of Gerbig, Snell/Weisheimer & Associates, Inc., an advertising agency.	1975	2007
Richard C. Notebaert	58	Chairman and Chief Executive Officer of Qwest Communications International Inc., a telecommunications systems company, July 2002 to present; President and Chief Executive Officer of Tellabs, Inc., a communications equipment and services	1999	2007

provider, September 2000 to July 2002  
(director of Qwest Communications  
International Inc.; and Aon Corporation).

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The Company's Board of Directors held four regular meetings and six special meetings during the fiscal year ended June 30, 2005 (fiscal 2005). Each Director attended 75% or more of the regular quarterly meetings of the Board and Board Committees on which he or she served. In addition, each Director attended 75% or more of the total of the regular and special meetings of the Board and Board committees on which he or she served, except for Mr. Bing, who attended 20 out of 27 of such meetings during fiscal 2005. Twelve of the Company's thirteen Directors attended the Company's 2004 Annual Meeting of Shareholders. Absent unusual circumstances, each Director is expected to attend the Annual Meeting of Shareholders.

*The Audit Committee.* Messrs. Finn (Chairman), Bing, Conrades, Gerbig, O'Halleran and Raisbeck are the current members of the Board's Audit Committee, which represents and assists the Board with the oversight of the integrity of the Company's financial statements, compliance with legal and regulatory requirements, the qualifications, independence and performance of the Company's independent auditors, and the qualifications and performance of the Company's internal audit function. The Audit Committee met 17 times during fiscal 2005.

The Board of Directors has determined that each of Messrs. Conrades, Finn, O'Halleran and Raisbeck is an audit committee financial expert for purposes of the rules of the Securities and Exchange Commission (the SEC). In addition, the Board of Directors has determined that each of the members of the Audit Committee is independent, as defined by the rules of the New York Stock Exchange.

*The Human Resources and Compensation Committee.* Messrs. McCoy (Chairman), Havens and Notebaert and Dr. Spaulding are the current members of the Board's Human Resources and Compensation Committee (the Compensation Committee), which was established to discharge the Board of Directors' responsibilities with respect to compensation of the Company's executives, sales to employees of stock in the Company and grants of stock-based incentives to employees, including stock options, restricted shares and restricted share units. The Compensation Committee also reviews and approves the Company goals and objectives relevant to the Chief Executive Officer's compensation and evaluates the Chief Executive Officer's performance in light of those goals and objectives. During fiscal 2005, the Compensation Committee met seven times and acted four times by written action without a meeting. The Board of Directors has determined that each of the members of the Compensation Committee is independent, as defined by the rules of the New York Stock Exchange.

*The Nominating and Governance Committee.* Messrs. Conrades (Chairman), Finn, Havens and McCoy are the current members of the Board's Nominating and Governance Committee, which was established for the purpose of identifying individuals qualified to become Board members (consistent with criteria approved by the Board), recommending director candidates for the Board, developing and reviewing the Company's Corporate Governance Guidelines, and performing a leadership role in shaping the Company's corporate governance practices. The Nominating and Governance Committee will consider director nominees recommended by shareholders as described under Corporate Governance Shareholder Recommendations for Director Nominees below. During fiscal 2005, the Nominating and Governance Committee met four times. The Board of Directors has determined that each of the members of the Nominating and Governance Committee is independent, as defined by the rules of the New York Stock Exchange.

*The Executive Committee.* Messrs. Conrades, Finn, McCoy and R. Walter are the current members of the Board's Executive Committee, which is empowered to exercise substantially all powers and perform all duties of the Board of Directors when the Board is not in session, other than the authority to fill vacancies on the Board or on any committee of the Board. During fiscal 2005, the Executive Committee did not meet and acted four times by written action without a meeting.

The Audit Committee Charter, approved in its current form by the Audit Committee in November 2004 and subsequently ratified by the Board of Directors, is attached as Appendix A to this Proxy Statement. The charters for each of the Audit, Compensation and Nominating and Governance Committees are available on the Company's website, at [www.cardinalhealth.com](http://www.cardinalhealth.com), under Investors Corporate Governance: Board committees/charters. This information also is available in print (free of charge) to any shareholder who requests it from the Company's Investor Relations department.



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**CORPORATE GOVERNANCE**

**Shareholder Recommendations for Director Nominees**

In nominating candidates for election as Director, the Nominating and Governance Committee will consider candidates recommended by shareholders. Shareholders who wish to recommend a candidate may do so by writing to the Nominating and Governance Committee in care of the Corporate Secretary, Cardinal Health, Inc., 7000 Cardinal Place, Dublin, Ohio 43017. Recommendations submitted for consideration by the committee in preparation for the 2006 Annual Meeting of Shareholders should be received no later than , 2006, and must contain the following information: (i) the name and address of the shareholder; (ii) the name and address of the person to be nominated; (iii) a representation that the shareholder is a holder of the Company's Common Shares entitled to vote at the meeting; (iv) a statement in support of the shareholder's recommendation, including a description of the candidate's qualifications; (v) information regarding the candidate as would be required to be included in a proxy statement filed in accordance with SEC rules; and (vi) the candidate's written, signed consent to serve if elected.

**Director Qualification Standards**

The Nominating and Governance Committee reviews with the Board from time to time the appropriate skills and characteristics required of Board members in the context of the make up of the Board and in developing criteria for identifying and evaluating qualified candidates for the Board. Candidates recommended by shareholders are evaluated based on the same criteria as candidates from other sources. These criteria, as described in the Company's Corporate Governance Guidelines, include an individual's business experience and skills, independence, judgment, integrity and ability to commit sufficient time and attention to the activities of the Board, as well as the absence of any potential conflicts with the Company's interests. Director candidates should also possess a skill set regarding current issues and priorities important to the Company and its operations. The Nominating and Governance Committee considers these criteria in the context of an assessment of the perceived needs of the Board as a whole and seeks to achieve diversity of occupational and personal backgrounds on the Board. If the Nominating and Governance Committee believes that a potential candidate may be appropriate for recommendation to the Board, there is generally a mutual exploration process, during which the Committee seeks to learn more about the candidate's qualifications, background and interest in serving on the Board, and the candidate has the opportunity to learn more about the Company, the Board and its governance practices. The final selection of the Board's nominees is within the discretion of the Board of Directors.

**Communicating with the Board**

The Board of Directors has established procedures by which shareholders and other interested parties may communicate with the Board, any committee of the Board, any individual Director or the independent or non-management Directors as a group. Such parties can send communications by e-mail to bod@cardinal.com or by mail to the Board of Directors in care of the Corporate Secretary, Cardinal Health, Inc., 7000 Cardinal Place, Dublin, Ohio 43017. This centralized process will assist the Board in reviewing and responding to communications. The name of any specific intended Board recipient should be noted in the communication. All communications are summarized for the Directors, and the actual communications are made available to the Directors upon request.

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**Corporate Governance Guidelines**

The Company has adopted Corporate Governance Guidelines, the full text of which is available on the Company's website, at [www.cardinalhealth.com](http://www.cardinalhealth.com), under Investors Corporate Governance: Corporate governance guidelines. This information also is available in print (free of charge) to any shareholder who requests it from the Company's Investor Relations department.

**Director Independence**

The Board has established categorical standards to assist it in making its determination of director independence. As embodied in the Company's Corporate Governance Guidelines, under standards that the Board has adopted to assist it in assessing independence, the Board defines an independent Director to be a Director who:

is not and has not been during the last three years an employee of, and whose immediate family member is not and has not been during the last three years an executive officer of, the Company (provided, however, that, in accordance with New York Stock Exchange listing standards, service as an interim executive officer, by itself, does not disqualify a Director from being considered independent under this test following the conclusion of that service);

has not received, and whose immediate family member has not received other than for service as an employee (who is not an executive officer), more than \$100,000 in direct compensation from the Company, other than Director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service), in any 12-month period during the last three years (provided however, that, in accordance with New York Stock Exchange listing standards, compensation received by a Director for former service as an interim executive officer need not be considered in determining independence under this test);

(a) is not, and whose immediate family member is not, a current partner of the Company's internal or external auditor; (b) is not a current employee of the Company's internal or external auditor; (c) does not have an immediate family member who is a current employee of the Company's internal or external auditor participating in the firm's audit, assurance or tax compliance (but not tax planning) practice; and (d) was not during the last three years, and whose immediate family member was not during the last three years, a partner or employee of the Company's internal or external auditor who personally worked on the Company's audit within that time;

is not and has not been during the last three years employed, and whose immediate family member is not and has not been during the last three years employed, as an executive officer of another company during a time when any of the Company's present executive officers serve on that other company's compensation committee;

is not a current employee of, and whose immediate family member is not a current executive officer of, a company that has made payments to, or received payments from, the Company for property or services in an amount which, in any of the last three fiscal years, exceeds the greater of \$1 million, or 2% of such other company's consolidated gross revenues;

is not, and whose spouse is not, an executive officer of a non-profit organization to which the Company or the Company foundation has made contributions during the past three years that, in any single fiscal year, exceeded the greater of \$1 million or 2% of the non-profit organization's consolidated gross revenues (amounts that the Company contributes under matching gifts programs are not included in the contributions calculated for purposes of this standard); and

has no other material relationship with the Company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the Company).



The Board of Directors has determined that each of Messrs. Bing, Conrades, Finn, Gerbig, Havens, Losh, McCoy, Notebaert, O Halleran and Raisbeck and Dr. Spaulding is independent under these categorical standards. Mr. Losh was determined to be independent under these categorical standards until late July 2004. From July 2004 until May 2005, Mr. Losh served as Chief Financial Officer of the Company on an interim basis and the Board of

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Directors determined that he was not independent during that time. Mr. Losh was again determined by the Board of Directors to be independent after his role as interim Chief Financial Officer ended in May 2005.

**Presiding Director**

The chairperson of the Nominating and Governance Committee or another Director selected by the non-management Directors will preside at the executive sessions of the non-management Directors, which will occur without management present at least four times each year, and at the executive sessions of the independent Directors, which will occur at least once per year. Mr. McCoy has been selected by the non-management Directors to preside over these executive sessions.

**Policies on Business Ethics; Chief Ethics and Compliance Officer**

All of Cardinal Health's employees, including its senior executives, and Directors are required to comply with the Company's Standards of Business Ethics to ensure that the Company's business is conducted in a consistently legal and ethical manner. The Sarbanes-Oxley Act of 2002 requires companies to have procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters and to allow for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters. The Company's procedures for these matters are set forth in the Standards of Business Ethics.

The full text of the Cardinal Health Ethics Guide, which includes the Standards of Business Ethics, is posted on the Company's website, at [www.cardinalhealth.com](http://www.cardinalhealth.com), under Investors Corporate Governance: Ethics policy. This information also is available in print (free of charge) to any shareholder who requests it from the Company's Investor Relations department. Cardinal Health will disclose future amendments to, or waivers from, its Standards of Business Ethics for its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions on its website within four business days following the date of the amendment or waiver. In addition, the Company will disclose any waiver from its Standards of Business Ethics for its executive officers and its Directors on its website.

In May 2005, the Company named a Chief Ethics and Compliance Officer who reports to both the Chief Executive Officer and the Audit Committee of the Board of Directors. The Chief Ethics and Compliance Officer is responsible for supporting the Board in its responsibility to evaluate, review and enhance the Company's corporate compliance program and ensuring senior leadership responsibility and accountability for compliance and ethical business conduct.

**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

In April 2005, the Company and a limited partnership, the limited partners of which include four adult children of Mr. Havens, one individually and the other three through separate trusts (representing an aggregate interest in the partnership of approximately 23%), jointly sold a property owned by the partnership and an adjoining property owned by the Company for an aggregate price, before closing expenses, of \$1,675,000. The net proceeds from the sale were allocated 67% to the partnership and 33% to the Company, which percentages represent the parties' interest in the square footage of the respective parcels. The property sold by the partnership was formerly leased by the Company from the partnership, which lease expired in fiscal 2004.

inChord Communications, Inc. (inChord) and its subsidiaries perform health care marketing and recruiting services on behalf of the Company and its subsidiaries from time to time in the ordinary course of business. Mr. M. Walter is a director and minority shareholder of inChord, and his two brothers serve as the other directors and own substantially all of the remaining equity interest in inChord. During fiscal 2005, the Company paid inChord approximately \$51,345 for services rendered on the Company's behalf, and has incurred approximately \$51,000 in additional amounts payable for services rendered on the Company's behalf in fiscal 2005.

In October 2003, the Company and inChord entered into a joint marketing program (RxPedit) designed to promote a comprehensive package of product commercialization services to pharmaceutical manufacturers. This program provides a mechanism for the parties to share the joint costs of the RxPedit marketing effort, and is terminable by either party at any time. During fiscal 2005, the Company's share of co-marketing expenses incurred in connection with the RxPedit program was approximately \$245,048.

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Mr. M. Walter and his two brothers own a majority of BoundTree Medical Products, Inc. ( *BMP* ), a company engaged in the pre-hospital emergency medical supply business. Mr. M. Walter is also an officer and director of *BMP*. During fiscal 2005, *BMP* and its affiliates (i) purchased approximately \$3,197,946 (which amount represents less than 5% of *BMP*'s consolidated gross revenues during such period) of product from the Company and its subsidiaries in the ordinary course of business, and (ii) sold products to the Company and its affiliates in the ordinary course of business totaling \$59,772.

The sister-in-law of Carole S. Watkins, Executive Vice President Human Resources of the Company, is employed as a senior vice president of the Company.

In April 2005, Medicine Shoppe International, Inc., a wholly-owned subsidiary of the Company ( *Medicine Shoppe* ), entered into a Membership Agreement with SureScripts, LLC, a provider of electronic prescription information communications services ( *SureScripts* ), pursuant to which Medicine Shoppe would become a member of a SureScripts program offering the electronic exchange of prescription information for the purpose of reducing medical errors, enhancing patient safety and increasing the efficiency of the prescribing process and other health care transactions and processes. Upon execution of the Membership Agreement, Medicine Shoppe paid SureScripts membership dues in the amount of \$969,300, which dues are based on a five-year membership period. The son-in-law of Mr. Conrades, a Director of the Company, is the Chief Executive Officer of SureScripts.

Pursuant to the Company's Code of Regulations and certain indemnification agreements, the Company is obligated to advance legal fees under certain circumstances to current and former employees, including executive officers and Directors, subject to limitations of the Ohio Revised Code. As part of that obligation, the Company has advanced legal fees relating to the representation of its Directors by counsel in connection with various derivative actions against the Company and its Directors, and relating to the representation of certain of its Directors and officers by counsel in connection with the SEC investigation and related investigations described under Item 3: Legal Proceedings of the Company's Form 10-K for the fiscal year ended June 30, 2005, under the headings Derivative Actions and SEC Investigation and U.S. Attorney Inquiry, respectively. The Company has advanced a total of approximately \$2.8 million relating to these matters since July 1, 2004.

See also Executive Compensation Compensation of Directors for a description of the Company's compensation arrangements with Mr. Losh while he was serving as the Company's Chief Financial Officer on an interim basis.

#### **SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Based solely upon a review of Forms 3, 4 and 5 and amendments thereto furnished to the Company during fiscal 2005 and written representations regarding the same, except as set forth below, all officers and Directors of the Company timely filed all reports required under Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), during fiscal 2005, except for the following: (a) Robert L. Gerbig, a Director, who provided an executed Form 4 to the Company on a timely basis, but due to an administrative oversight by the Company, such Form 4 was filed late after the oversight was discovered; (b) Brendan A. Ford, the Company's Executive Vice President Corporate Development and Interim General Counsel and Secretary, who was late in reporting one acquisition of 40 Common Shares; and (c) Anthony J. Rucci, the Company's Executive Vice President and President of Strategic Corporate Resources, who was late in reporting the gift of an option to purchase shares.

**Table of Contents****SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS  
AND MANAGEMENT**

The following table sets forth certain information regarding the beneficial ownership of the Company's Common Shares as of September 9, 2005 (unless otherwise indicated below) by: (a) the Company's Directors; (b) each other person who is known by the Company to own beneficially more than 5% of the outstanding Common Shares; (c) the Company's Chief Executive Officer and the other executive officers named in the Summary Compensation Table; and (d) the Company's current executive officers and Directors as a group. Except as otherwise described in the notes below, the listed beneficial owners have sole voting and investment power with respect to all Common Shares set forth opposite their names:

<b>Name of Beneficial Owner</b>	<b>Number of Common Shares Beneficially Owned</b>	<b>Percent of Class</b>
FMR Corp. (1)	49,579,927	11.6%
Dodge & Cox (2)	34,991,899	8.2%
Robert D. Walter (3)(4)(5)(6)	5,267,321	1.2%
Matthew D. Walter (7)(8)	1,419,240	*
George L. Fotiades (4)(5)(6)	334,312	*
Anthony J. Rucci (4)(5)(6)	222,022	*
Ronald K. Labrum (4)(5)(6)	207,642	*
John B. McCoy (7)(9)(10)	126,421	*
David L. Schlotterbeck (4)(5)(6)	99,164	*
Robert L. Gerbig (7)	95,065	*
John F. Finn (7)(10)(11)	62,242	*
John F. Havens (7)(10)	61,109	*
Richard C. Notebaert (7)(10)	39,419	*
Michael D. O'Halleran (7)	31,630	*
J. Michael Losh (7)(10)(12)	31,363	*
Dave Bing (7)(10)	27,752	*
George H. Conrades (7)(10)	26,819	*
David W. Raisbeck (7)(10)	20,755	*
Jean G. Spaulding, M.D. (7)(10)	17,896	*
All Executive Officers and Directors as a Group (25 Persons) (13)	8,631,523	2.0%

\* Indicates beneficial ownership of less than 1% of the outstanding Common Shares.

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- (1) Based on information obtained from a Schedule 13G/A jointly filed with the SEC on February 14, 2005 by FMR Corp. ( FMR ), Edward C. Johnson, III and Abigail P. Johnson. The address of FMR is 82 Devonshire Street, Boston, Massachusetts 02109. FMR reported that, as of December 31, 2004, it had sole voting power with respect to 1,422,329 Common Shares and sole dispositive power with respect to all Common Shares shown in the table. The number of shares held by FMR may have changed since the filing of the Schedule 13G/A.
- (2) Based on information obtained from a Schedule 13G filed with the SEC on February 10, 2005 by Dodge & Cox. The address of Dodge & Cox is 555 California Street, San Francisco, California 94104. Dodge & Cox reported that, as of December 31, 2004, it had sole voting power with respect to 32,764,899 Common Shares, shared voting power with respect to 528,400 Common Shares and sole dispositive power with respect to all Common Shares shown in the table. The number of shares held by Dodge & Cox may have changed since the filing of the 13G.
- (3) Includes a total of 1,710,913 Common Shares held in three grantor retained annuity trusts of which Mr. R. Walter is the trustee, and 800,000 Common Shares beneficially owned by Mr. R. Walter through two limited liability companies in which Mr. R. Walter holds the controlling interest and is the sole manager.
- (4) Common Shares and the percent of class listed as being beneficially owned by the Company's named executive officers include outstanding options to purchase Common Shares that are exercisable within 60 days of September 9, 2005, as follows: Mr. R. Walter 1,488,402 shares; Mr. Fotiades 279,773 shares; Mr. Schlotterbeck 0 shares; Mr. Labrum 199,068 shares; and Mr. Rucci 184,207 shares (which options are held in a trust of which Mr. Rucci is trustee and the sole beneficiary during his life).
- (5) Common Shares and the percent of class listed as being beneficially owned by the Company's named executive officers do not include restricted share units as of September 9, 2005, as follows: Mr. R. Walter 318,895 shares; Mr. Fotiades 26,362 shares; Mr. Schlotterbeck 0 shares; Mr. Labrum 24,041 shares; Mr. Rucci 43,187 shares. Such restricted share units are not deemed to be beneficially owned under SEC rules.
- (6) Common Shares and the percent of class listed as being beneficially owned by the Company's named executive officers include Common Shares in the Company's Employee Stock Purchase Plan as of September 9, 2005, as follows: Mr. R. Walter 2,826 shares; Mr. Fotiades 0 shares; Mr. Schlotterbeck 437 shares; Mr. Labrum 2,816 shares; and Mr. Rucci 0 shares.
- (7) Common Shares and the percent of class listed as being beneficially owned by the listed Company Directors (except for Mr. R. Walter) include outstanding options to purchase Common Shares that are exercisable within 60 days of September 9, 2005, as follows: Mr. Bing 27,752 shares; Mr. Conrades 25,819 shares; Mr. Finn 31,943 shares; Mr. Gerbig 31,943 shares; Mr. Havens 35,075 shares; Mr. Losh 26,488 shares; Mr. McCoy 31,943 shares; Mr. Notebaert 25,819 shares; Mr. O Halleran 24,130 shares; Mr. Raisbeck 17,755 shares; Dr. Spaulding 17,746 shares; and Mr. M. Walter 17,746 shares.
- (8) Includes 31,097 Common Shares held in trust for the benefit of Mr. M. Walter, 1,112,663 Common Shares beneficially owned by Mr. M. Walter through a limited liability company he controls, 84,889 Common Shares held in a grantor retained annuity trust of which Mr. M. Walter is the trustee, 34,502 Common Shares held in a trust in which Mr. M. Walter holds a one-third economic interest and of which he is a co-trustee, 6,840 Common Shares held in trusts for the benefit of Mr. M. Walter's children, and 1,090 Common Shares held by Mr. M. Walter's spouse.
- (9) Includes 34,137 Common Shares held in trust for the benefit of Mr. McCoy, 6,436 Common Shares held in trust for the benefit of Mr. McCoy's son and a total of 50,773 Common Shares held in two grantor retained annuity trusts of which Mr. McCoy is the trustee.
- (10) Common Shares and the percent of class listed as being beneficially owned by the Company's non-management Directors do not include Common Share units held under the Company's Directors Deferred Compensation Plan as of September 9, 2005, as follows: Mr. Bing 3,669 share units; Mr. Conrades

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1,635 share units; Mr. Finn 4,659 share units; Mr. Havens 3,739 share units; Mr. Losh 3,293 share units; Mr. McCoy 4,515 share units; Mr. Notebaert 3,739 share units; Mr. Raisbeck 2,418 share units; and Dr. Spaulding 1,779 share units. Such Common Share units are not deemed to be beneficially owned under SEC rules.

(11) Includes 1,032 Common Shares held by Mr. Finn's spouse.

(12) Includes 1,500 Common Shares held in trust for the benefit of Mr. Losh's daughters.

(13) Common Shares and percent of class listed as being beneficially owned by all executive officers and Directors as a group include outstanding options to purchase an aggregate of 2,924,370 Common Shares that are exercisable within 60 days of September 9, 2005.

**EXECUTIVE COMPENSATION**

**Human Resources and Compensation Committee Report**

The Company's executive compensation program is administered by the Human Resources and Compensation Committee (the Compensation Committee) of the Company's Board of Directors, which is responsible for reviewing all aspects of compensation for the Company's executive officers. The Compensation Committee is currently comprised of Messrs. Havens, McCoy and Notebaert and Dr. Spaulding, with Mr. McCoy serving as Chairman.<sup>1</sup> The Compensation Committee's primary objective with respect to the Company's executive compensation practices is to establish and maintain programs that attract, motivate and retain key executives and align their compensation with the Company's overall business strategies, core values adopted by the Company as part of its performance culture (the EPIC Core Values) and the Company's performance. To this end, the Compensation Committee has established, and the Board of Directors has endorsed, an executive compensation philosophy which includes the following considerations:

A pay-for-performance orientation that differentiates compensation results based upon corporate, business unit and individual performance;

An appropriate mix of short-term and long-term compensation that facilitates retention of talented executives and encourages Company stock ownership;

An emphasis on long-term incentives as a significant component of total compensation in order to more closely align the interests of Company executives with the economic interests of the Company's shareholders;

An emphasis on total compensation versus cash compensation, rewarding Company executives with total compensation (including cash and stock incentive programs) at or above competitive levels to the extent individual performance and business results are superior and demonstrate commitment to the Company's EPIC Core Values; and

Recognition that as an executive's level of responsibility increases, a greater portion of that executive's total compensation opportunity should be at risk and based upon stock and other performance-based incentives.

The primary components of the Company's executive compensation program for fiscal 2005 were (a) base salaries, (b) annual cash incentive opportunities and (c) long-term incentive opportunities in the form of stock options and restricted share units. This three-part approach was intended to enable the Company to meet the requirements of the highly competitive environment in which the Company operates while ensuring that executive officers are compensated in a way that advances both the short- and long-term economic interests of shareholders.

<sup>1</sup> Mr. Losh was Chairman of the Compensation Committee until

July 24, 2004, when he was appointed the Company's Chief Financial Officer on an interim basis.

Mr. Losh served in such position until May 15, 2005.

<sup>2</sup> EPIC Core Values are Ethical, Performance-Driven, Innovative and Collaborative.

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The executive officers' and CEO's base salary, annual bonus target and award, and long-term incentives are reviewed by the Compensation Committee at least annually to ensure market competitiveness and to assure satisfaction of the Company's objective of providing total executive pay that achieves an appropriate balance of variable pay-for-performance and at-risk equity compensation. The Compensation Committee has retained and is advised directly by an executive compensation consulting firm in its review of Mr. R. Walter's and the other executive officers' compensation. In making its recommendations, the consultant considered a comparator group of companies for the Company that includes some, but not all, of the companies included in the Value Line Health Care Index utilized for the Shareholder Performance Graph set forth below. The companies considered by the consultant represent a broad spectrum of approximately 40 wholesale, retail and manufacturing companies that the consultant and the Compensation Committee believe to be a more representative measure of the size, scope, performance and complexity of the competitive market for executive talent than the Value Line Health Care Index.

In reviewing compensation of the Company's executive officers for fiscal 2005 (including that of Mr. R. Walter), the Compensation Committee considered multiple factors, including the Company's performance in a year of significant change and difficult business conditions, as well as the Company's size and complexity, overall quality of earnings performance, balance sheet and cash flow performance, foreign operations, individual business results and total shareholder return. The Compensation Committee also considered each executive officer's individual performance (including demonstration of core leadership competencies and promotion of the Company's EPIC Core Values), retention and contribution toward positioning the Company for future success.

*Base Salaries.* Base salaries for Company executives are generally subject to annual review and adjustment on the basis of the following: individual and Company performance; level of responsibility; market data; and competitive, inflationary and internal equity considerations. Salary increases for fiscal 2005 for executive officers who were employed by the Company in fiscal 2004 (other than Mr. R. Walter) ranged from approximately 3.5% to 12% over such officers' fiscal 2004 salaries.

*Annual Cash Incentives.* As part of the Company's executive compensation program, Company executives are eligible to receive annual cash incentive awards pursuant to the Company's annual cash incentive program. Targeted cash incentive amounts, which range from 65% to 140% of annual base salary for executive officers (other than Mr. R. Walter), are designed to provide competitive incentive pay and reflect the Company's pay-for-performance philosophy. These targets are reviewed periodically, but are generally not modified annually. Targeted cash incentive amounts generally represent a greater portion of an executive's overall potential cash compensation as levels of responsibility and function increase. Performance objectives intended to focus attention on achieving key goals are established for the Company, for each segment and for each business unit within each segment at the beginning of each fiscal year. In addition, individual performance objectives are established for each executive, which include both specific performance goals and other, more qualitative and developmental criteria.

Certain of the executive officers' bonuses are paid under the Company's Management Incentive Plan (the "MIP"). Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), prohibits a deduction to any publicly held corporation for non-performance-based compensation paid to a covered employee in excess of \$1 million per year (the "Dollar Limitation"). A covered employee is an employee who, on the last day of a company's taxable year, is the chief executive officer of the company or an employee who appears in the Summary Compensation Table by reason of being one of the four most highly compensated executive officers for the taxable year (other than the chief executive officer). In anticipation that the deductibility of compensation paid to Mr. R. Walter and other executive officers could be affected by Section 162(m), in August 1996, the Company's Board of Directors adopted the MIP, the material terms of the performance goals of which have been approved by the Company's shareholders. In August 2004, the Board of Directors approved amendments to the MIP, and such amendments were approved by the Company's shareholders in December 2004. Compensation paid in accordance with the MIP generally will not be applied toward the Dollar Limitation.

Messrs. R. Walter, Fotiades, Schlotterbeck, Labrum and Rucci were the Company's covered employees for fiscal 2005. Under the terms of the MIP, and in accordance with Section 162(m), a maximum bonus potential level was set for each covered employee if the performance goals established by the Compensation Committee were fully satisfied. The performance goals established by the Compensation Committee under the MIP for covered employees for fiscal



2005 were the achievement by the Company of a specified level of earnings per share growth and a specified level of return on average shareholder's equity. These performance goals were not fully satisfied for fiscal 2005. As a result, that portion of an incentive compensation award paid to an

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executive officer for fiscal 2005, which together with such executive officer's base salary and any other non-performance based compensation for fiscal 2005 exceeds \$1 million, will not be deductible to the extent provided by Section 162(m).

In addition to the MIP performance goals, the Compensation Committee considered corporate, business segment and individual performance in determining annual cash incentive awards to executive officers for fiscal 2005. For many of the performance objectives established for the Company's executives, the Company and its business segments did not achieve results that would entitle the executives to their full bonus target amount. However, the Committee also considered that fiscal 2005 was a year of significant change and difficult challenges for the Company, with significant events that required extraordinary management efforts in a complex environment. Major efforts were made during fiscal 2005 to develop a new organizational structure and implement a strategic agenda that focuses on the long-term. With respect to executive officer incentive awards, the Compensation Committee also considered that executive officers of the Company did not receive a bonus for fiscal 2004. As a result of these factors, the Compensation Committee approved annual cash incentive award allocations to the Company's business segments for fiscal 2005 ranging from 49% to 77% of the target award amount for non-executive officers, and payments of 60% of the target award for executive officers whose incentive compensation was not fixed by contract. In addition, following preliminary discussions by the Compensation Committee of anticipated cash incentive awards to executive officers for fiscal 2005, Mr. R. Walter discussed with the Compensation Committee his desire that his ultimate bonus to be awarded by the Compensation Committee be reduced by the Compensation Committee, and that such reduced amount be used to provide an increased pool for the fiscal 2005 cash incentive awards of executive officers other than Mr. Fotiades and those executive officers who had fiscal 2005 bonus guarantees as part of their compensation arrangements with the Company. As a result of those discussions, the Compensation Committee awarded each such executive officer an additional 20% of his or her respective actual fiscal 2005 award.

*Long-Term Stock Incentives.* The Company has granted equity-based awards to its executives under the Company's Amended and Restated Equity Incentive Plan, as amended (the "Equity Incentive Plan"). The Equity Incentive Plan was approved by the Company's shareholders in November 1995, and amendments were approved by the Company's shareholders in November 1998. The Equity Incentive Plan has been designed to align a significant portion of the executive compensation package with the long-term economic interests of the Company's shareholders by providing an incentive that focuses attention on managing the Company from the perspective of a longer-term owner with an equity stake in the business. The Equity Incentive Plan provides for the grant of several types of equity-based awards, including stock options and restricted shares and share units.

The Company has historically made annual grants of stock options to its management personnel, including its executive officers. This annual grant program has been designed to provide Company managers, over a number of years, with multiple stock option awards, each granted with an exercise price equal to the market price for Common Shares on the date of the grant. Individual option grants historically have been determined by the Compensation Committee based on a manager's current performance, potential for future responsibility, market competitiveness (based on data provided by the Company's outside compensation consultant) and salary multiples designed to increase the portion of the total compensation opportunity represented by stock incentives as a manager's level of responsibility increases. Because a primary purpose of granting stock options has been to encourage positive future performance, when granting options in fiscal 2005, the Compensation Committee did not consider the number of options granted to an individual in previous years or the amount of stock owned by the executive. The Company's current standard stock option agreement contains provisions providing for forfeiture of the option or option value received in the event the option holder engages in certain behavior in competition with or contrary to the interests of the Company. The Compensation Committee has historically placed a relatively heavy emphasis on equity incentives, consistent with its philosophy that stock incentives more closely align the interests of Company managers with the long-term interests of shareholders.

In August 2004, the Committee awarded stock option grants to approximately 5,270 employees below the executive officer level for fiscal 2005 under the Company's Equity Incentive Plan and Broadly-based Equity Incentive Plan, as amended (the "Broadly-based Equity Incentive Plan"). This program has historically been an important element of the Company's efforts to identify, develop and motivate key employees who will be influential in the achievement

of the Company's long-term goals.

Grants of restricted shares and restricted share units are intended to reward exceptional performance with a long-term benefit in lieu of cash, to facilitate stock ownership and to promote retention of key Company managers.

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Unlike the Company's stock option program, restricted share and restricted share unit grants have not historically been made on an annual or other regularly established basis. Recipients of restricted share and restricted share unit grants are subject to restrictions on the disposition of the stock during a period determined by the Compensation Committee at the time of grant. Generally, restricted share and restricted share unit awards are forfeited by their terms if the recipient terminates employment with the Company prior to the expiration of the restriction or vesting period. Restricted share and restricted share unit awards are, in most instances, also forfeited by their terms if the recipient engages in certain behavior in competition with or contrary to the interests of the Company.

As discussed in more detail beginning on page 32 of this Proxy Statement, the Compensation Committee has approved