

## **DOCUMENT SECURITY SYSTEMS, INC.**

### **Corporate Governance Principles**

The Board of Directors (the "Board") of Document Security Systems, Inc. ("the Company") is elected by the Company's shareholders to oversee the management and conduct of the Company's business. The directors should exercise their business judgment in good faith and in what they reasonably believe to be the best interests of the Company. It is the ultimate decision-making body of the Company, except with respect to matters reserved to the shareholders. The Board elects the Company's senior management and then oversees their operation and performance, and provides advice and counsel, all in the interests of enhancing the long-term value of the Company for the benefit of shareholders. In discharging their obligations, directors should be entitled to rely on the honesty and integrity of their fellow directors as well as the Company's senior management and outside advisors and auditors.

The Board has adopted the following Corporate Governance Principles ("the Principles") to assist the Board in the exercise of its duties and responsibilities and to serve the best interests of the Company and its stockholders. The Principles should be applied in a manner consistent with any applicable rules and regulations of the Securities and Exchange Commission and the principal exchange or over the counter market upon which the Company's securities are listed for trading and the Company's By-Laws, each as may be amended and in effect from time to time. The Principles provide a framework for the conduct of the Board's business. The Nominating and Corporate Governance Committee shall periodically review and reassess the adequacy of these Principles and recommend any proposed changes to the Board for approval.

In fulfilling its role, the Board will be governed by the following principles:

#### **Selection and Composition of the Board**

##### **1. Size of the Board**

According to the Company's By-Laws, the Board may have no fewer than three and no more than seven members. Most recently, the Board was increased, in January 2004 to a total of six members. The Board believes that this is an appropriate size range, although the total membership of the Board may change if circumstances so warrant. The precise number of members will be determined from time to time by resolution adopted by a majority of directors in office at the time of the vote, with the objective of achieving a size sufficiently large to encompass members with significant breadth in experience and skills, while still small enough to function efficiently.

## 2. Election of Directors

The Board is not currently classified into classes and members are elected to one year terms. It is the policy of the Board to hold an Annual Meeting of the Company for the election of Directors every year.

## 3. Director Independence and Qualifications

At all times, at least two directors shall be “independent directors” as defined by the rules of the American Stock Exchange, as may be modified from time to time or as may be otherwise required by federal securities laws. The Board envisions that independent, non-management directors will represent a majority of the Board and that, in any event, at any given time no more than two Board members may also hold management positions with the Company. The Nominating and Corporate Governance Committee is responsible for reviewing the qualifications and independence of Board members.

## 4. Board Membership Criteria

The Nominating and Corporate Governance Committee of the Board is responsible for screening potential director candidates and recommending nominees for election to the Board. In considering potential candidates, the Committee and the Board consider a number of factors, including the following:

employment and other professional experience;

expertise and involvement in areas that are of relevance to the Company's business;

business ethics and professional reputation;

other Board experience; and

the desire to have a Board that represents a diverse mix of backgrounds, perspectives and expertise.

These criteria are more fully detailed in the Committee's “Policy With Regard to Consideration of Candidates Recommended for Election to the Board of Directors,” which shall be available on the Company's web site or upon written request to the Company's Secretary sent to the Company's corporate headquarters.

## 5. Retirement Age

Recognizing the breadth of knowledge and experience its directors may provide, the Board has not established a retirement age for directors. All directors must continue to meet the criteria for

Board service established by the Nominating and Corporate Governance Committee.

#### 6. Term Limits

The Board believes that much of the knowledge of the Company's operations, management and business is cumulative. Therefore, the Board does not believe that fixed term limits are advisable, as they can interfere with the overall objective of maintaining the highest possible functionality and contribution from its members. The Board believes there is a benefit to maintaining a significant degree of continuity among directors, as members are able to gain greater insight into the Company over time, increasing the value of their contributions. At the same time, however, the Nominating and Corporate Governance Committee has the responsibility to monitor and assess the contribution of every director standing for re-election to assure that each such director is meeting the expectations necessary for continued service on the Board.

### **Board Leadership**

#### 7. Selection of the Chairman

The Chairman of the Board will normally be elected by the Board on an annual basis, typically after the Company's annual meeting of shareholders. The Nominating and Corporate Governance Committee recommends to the Board a candidate for election as Chairman. The Chairman of the Board presides over all meetings of the Company's Board at which he/she is in attendance. The Board may consider or determine that the position of Chairman and Chief Executive Officer should be separate.

### **Operation of the Board**

#### 8. Frequency of Board Meetings

The Board has determined to have four, regularly-scheduled monthly meetings each year, a minimum of one of which shall be in-person. The remaining meetings will be held by telephone conference. The number of meetings may change at the discretion of the Board, and the Board may meet more frequently, in-person or by telephone, if circumstances warrant.

#### 9. Board Meeting Agendas; Advance Materials

The Board, in consultation with the Chief Executive Officer, is responsible for determining its agenda. Any director may request that a matter be placed on the Board's agenda by contacting either the Secretary or the Chief Executive Officer, and members are encouraged to suggest items for inclusion in the agenda. The agenda is provided to Board members in advance of the meeting, along with written materials on certain matters being presented for consideration. Notice of Meetings shall be sent to each Board member in accordance with the Bylaws, or may be waived at meetings attended in person or by telephone by all Directors.

## 10. Executive Sessions

The Board believes that it is important for independent, non-management directors to meet periodically in executive session without management directors present. Executive sessions of the independent directors are scheduled to occur in conjunction with each regularly-scheduled, in-person meeting of the Board. Any director may request additional sessions of the independent directors to address any area of concern. The Chairman will preside over executive sessions. Should the Chairman not be an independent director, the Nominating and Corporate Governance Committee may nominate an independent director to serve as “Lead Director,” who shall be approved by a majority of the independent directors and shall chair any executive session of the independent directors.

## 11. Board Self-Assessment

The Board will assess its performance on an annual basis, through a self-evaluation process coordinated by the Nominating and Corporate Governance Committee. The results will be analyzed by the Committee and reported to the full Board annually. The Committee will identify any areas for potential improvement and develop recommendations for future upgrades to the performance, processes and operation of the Board.

## 12. Evaluation and Compensation of the Chief Executive Officer

At the beginning of each fiscal year, the Compensation and Management Resources Committee, with input from other independent members of the Board, shall establish performance goals for the Chief Executive Officer. These goals may be modified during the course of the year if unforeseen business circumstances warrant. At year-end, or throughout the year, as may be appropriate, the Chief Executive Officer will report to the Board on the achievement of these goals. At fiscal year end, the Committee, in consultation with the other non-management members of the Board, will evaluate the performance of Chief Executive Officer of the Company. The Committee is also responsible for approving the compensation of the Chief Executive Officer, as well as evaluating and approving the compensation of the Company’s senior executives (provided, however, that the Committee may also determine to evaluate senior financial executives performance in conjunction with the Audit Committee).

## 13. Interaction with Senior Management

Board members have complete access to members of senior management, and to other employees of the Company with whom they want to speak. Non-management directors may speak with individual members of management or other employees of the Company on a confidential basis. It is understood that Board members will use judgment to assure that this contact is not distracting to the business operation of the Company and the operations and oversight of the day to day management of the Company by the Chief Executive Officer. It is not the position of the Board that the Board members be involved in the day to day operations of the Company. Additionally, the Board may schedule or request that the Chief Executive Officer

schedule informal meetings with departmental managers of the Company in conjunction with regularly-scheduled, in-person meeting of the Board.

Certain members of senior management, such as the Chief Financial Officer and the General Counsel (if any), may be regular attendees at Board meetings to help facilitate the operations of the Board. The Board also intends to have outside counsel attend Board meetings to provide additional advice on matters that may be relevant. In addition, the Board encourages management to periodically invite other executives to make presentations at Board meetings and attend Board functions in order to provide the Board with additional insight into the Company and provide the Board with exposure to individuals whom management believes are potential succession candidates.

#### 14. Succession Planning

The Compensation and Management Resources Committee shall recommend to the full Board for its approval a succession plan for the Chief Executive Officer developed by management and approved by the Committee. The plan shall address the policies and principles for selecting a successor to the Chief Executive Officer, both in an emergency situation and in the ordinary course of business. The Committee shall also review programs created and maintained by management for the development and succession of the Company's other executive officers and any other individuals identified by senior management or the Committee.

#### 15. Board Interaction with Third Party Constituencies

The Board believes that management speaks for the Company, and therefore it will not normally be appropriate for Board members to speak on behalf of the Company to investors, employees, the press or other third parties. However, there may be instances in which selected Board members may be asked to participate in conversations with representatives of various constituencies, although those interactions will be coordinated with appropriate members of senior management.

In addition, the Company has established a process for interested shareholders to contact members of the Board either individually or as a group by mail addressed to a director by name or to the Board of Directors c/o Corporate Secretary, 28 E. Main Street, Rochester, NY 14614 or by electronic mail to [cherrie.mahon@documentsecurity.dom](mailto:cherrie.mahon@documentsecurity.dom) and putting the name of the director, if the communication is to be to an individual director, in the subject line. The Secretary of the Company will ensure that mailed and electronic mail communications are forwarded to the appropriate Board members.

#### 16. Access to Independent Advisors

The Board and its Committees have the right at any time to retain independent financial, legal or other advisors, and the Company shall pay all expenses incurred in connection with such independent advisors.

## 17. Director Orientation and Continuing Education

The Nominating and Corporate Governance Committee is charged with developing and overseeing the implementation and operation of a new director orientation program and determining whether and what form of continuing education for directors is appropriate. In addition, management will provide further information on an ongoing basis to assure that Board members are aware of the business, legal and other developments necessary to fulfill their role, and will make available such outside educational opportunities as the Board deems relevant and appropriate.

## **Requirements of Board Service**

### 18. Attendance at Board Meetings

It is the expectation that directors will attend all Board meetings, and all meetings of Committees upon which they serve, and spend the time necessary to properly discharge their responsibilities, including the time necessary to carefully review all materials provided in advance of meetings. In the unusual instance when a Board member cannot attend a scheduled in-person meeting, he or she will make every effort to participate by telephone.

### 19. Code of Ethics

All Board members are subject to the Company's Code of Ethics ("Code"). The Code, and any waivers granted thereunder, for directors and executive officers, will be disclosed in compliance SEC rules and regulations, with American Stock Exchange rules and other applicable legal requirements.

### 20. Limits on Service With Other Boards

There is no pre-determined limitation on Board members' membership on the boards of other companies or charitable institutions. It is expected that each director will devote the time and effort necessary to discharge his or her duties in an appropriate and diligent fashion, irrespective of other activities and commitments. In the event this is not occurring, whether because of service on other boards or for some other reason, the matter will be addressed by the Nominating and Corporate Governance Committee.

## **Committee Matters**

### 21. Number and Types of Committees

The Board has determined that the following four committees serve important functions in assisting it to fulfill its role: the Audit Committee, the Management Resources and Compensation Committee and the Nominating and Corporate Governance Committee. The Board does not believe that any additional committees are necessary at this time.

## 22. Independence of Committee Members

Each member of the Audit Committee, the Compensation and Management Resources Committee and the Nominating and Corporate Governance Committee shall meet the independence requirements set forth in the American Stock Exchange rules. All of the Audit Committee members shall be “financially sophisticated” in accordance with the American Stock Exchange standards. At least one member of the Audit Committee shall be an “audit committee financial expert” in accordance with applicable Securities and Exchange Commission regulations.

## 23. Committee Charters

Each Committee has a written Charter, which will be reviewed annually. The Charters of the Audit Committee, the Management Resources and Compensation Committee and the Nominating and Corporate Governance Committee will comply in all respects with the American Stock Exchange Rules.

## 24. Committee Agendas

The agendas for each Committee meeting will be determined by the Chair of that Committee, in conjunction with fellow Committee members and appropriate members of management. The agenda is provided to Committee members in advance of each meeting, along with written materials on certain matters being presented for consideration.

## 25. Committee Operation

Committees will meet at such times and with such frequency as is required by their Charters and as is necessary to conduct their assigned business. Each Committee has the ability to delegate matters to a sub-committee to the extent it believes such delegation will assist in the evaluation or decision-making process. The Chairs of each of the Committees are responsible for providing timely reports to the Board regarding the deliberations, recommendations and decisions of their respective Committees. Each Committee – as does the Board - has authority to obtain advice and assistance from external legal, accounting or other experts, advisors and consultants to assist in carrying out its duties and responsibilities and has the authority to retain and approve fees for any external experts, advisors or consultants.

## 26. Assignment and Rotation of Committee Members

Assignment of Board members to various Committees, and selection of Committee Chairs, are reviewed at least annually by the Nominating and Corporate Governance Committee. It is the sense of the Board that a balance should be struck between the desirability of continuity in Committee assignments - which allows for greater depth of understanding by Committee members of their roles - and the need to periodically add new perspectives and avoid stagnation. These factors are taken into account in determining annual Committee assignments, but the

Board does not believe that an inflexible, formal rotation schedule would be productive.

#### 27. Committee Self-Assessments

In addition to the self-assessment process for the Board as a whole, each of the Audit Committee, the Management Resources and Compensation Committee and the Nominating and Corporate Governance Committee will conduct annual self-assessments.

### **Board Compensation**

#### 28. Determination of Compensation

The Nominating and Corporate Governance Committee is responsible for making recommendations to the full Board regarding the components and amount of director compensation. Such recommendations are based on compensation levels at entities comparable to the Company, and will be set at levels necessary to attract and retain high caliber Board members and appropriately compensate them for their time and effort.

#### 29. Mix of Compensation

The Board believes that compensation for directors should include a mix of elements, but should include some component of equity, to align the interests of Board members with shareholders.

#### 30. Share Ownership by Directors

The Board believes that share ownership by directors is desirable, in that it aligns the interests of directors and shareholders. Under the Non-Executive Director Stock Option Plan, each non-management director will be awarded 5,000 options upon joining the Board and on January 2<sup>nd</sup> of each year assuming the member has served for the entire year.