

COMMUNITY BANK SYSTEM INC

Form DEF 14A

April 12, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
SCHEDULE 14A**

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 §240.14a-12

Community Bank System, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
  - Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
- (1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

- o Fee paid previously with preliminary materials.
- o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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COMMUNITY BANK SYSTEM, INC.  
5790 Widewaters Parkway  
DeWitt, New York 13214-1883

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

April 12, 2007

**To the Shareholders of Community Bank System, Inc.:**

At the direction of the Board of Directors of **Community Bank System, Inc.**, a Delaware corporation (the Company ), **NOTICE IS HEREBY GIVEN** that the Annual Meeting of Shareholders of the Company (the Meeting ) will be held at 1:00 p.m. on Tuesday, May 15, 2007 at Clarkson University, Cheel Campus Center in Potsdam, New York for the purpose of considering and voting upon the following matters:

1. The election of three directors to hold office for a term of three years and until their successors have been duly elected.
2. To ratify the appointment of PricewaterhouseCoopers LLP as the Company s independent registered public accounting firm for the 2007 fiscal year; and
3. The transaction of any other business which may properly be brought before the Meeting or any adjournment thereof.

By Order of the Board of Directors  
Donna J. Drengel  
Secretary

**YOUR VOTE IS IMPORTANT. YOU ARE THEREFORE REQUESTED TO SIGN AND RETURN THE ENCLOSED PROXY CARD AS PROMPTLY AS POSSIBLE, EVEN IF YOU EXPECT TO BE PRESENT AT THE MEETING. YOU MAY WITHDRAW YOUR PROXY AT ANY TIME PRIOR TO THE MEETING, OR IF YOU DO ATTEND THE MEETING, YOU MAY WITHDRAW YOUR PROXY AT THAT TIME AND VOTE IN PERSON IF YOU WISH.**

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COMMUNITY BANK SYSTEM, INC.  
5790 Widewaters Parkway  
DeWitt, New York 13214-1883

**PROXY STATEMENT  
FOR ANNUAL MEETING OF SHAREHOLDERS, MAY 15, 2007**

This Proxy Statement is furnished as part of the solicitation of proxies by the Board of Directors (the **Board**) of Community Bank System, Inc. (the **Company**), the holding company for Community Bank, N.A. (the **Bank**), for use at the Annual Meeting of Shareholders of the Company (the **Meeting**) to be held at 1:00 p.m. on Tuesday, May 15, 2007, at Clarkson University, Cheel Campus Center in Potsdam, New York. This Proxy Statement and the form of Proxy are first being sent to Shareholders on approximately April 12, 2007.

At the Meeting, the Shareholders will be asked to vote for the election of directors and the ratification of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the 2007 fiscal year. Three of the total of ten directors who currently serve on the Company's Board (excluding the current director whose term will not continue after the Meeting) will stand for re-election to the Board at the Meeting. Director Harold S. Kaplan's term will expire at the Meeting and the Board will be reduced to nine members. Voting will also be conducted on any other matters which are properly brought before the Meeting.

**VOTING RIGHTS AND PROXIES**

The Board has fixed the close of business on March 29, 2007 as the record date for determining which Shareholders are entitled to notice of and to vote at the Meeting. At the close of business on the record date, 30,096,155 shares of common stock, \$1.00 par value, were outstanding and entitled to vote at the Meeting. This is the Company's only class of voting stock outstanding. Each share of outstanding common stock is entitled to one vote with respect to each item to come before the Meeting. There will be no cumulative voting of shares for any matter voted upon at the Meeting. The Bylaws of the Company provide that one-third of the outstanding shares of the Company, represented in person or by proxy, shall constitute a quorum at a Shareholder meeting.

If the enclosed form of Proxy is properly executed and returned to the Company prior to or at the Meeting, and if the Proxy is not revoked prior to its exercise, all shares represented thereby will be voted at the Meeting and, where instructions have been given by a Shareholder, will be voted in accordance with such instructions.

Any Shareholder executing a Proxy which is solicited hereby has the power to revoke it at any time prior to its exercise. A Proxy may be revoked by giving written notice to the Secretary of the Company at the Company's address set forth above, by attending the Meeting and voting the shares of stock in person, or by executing and delivering to the Secretary a later-dated Proxy.

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The Company will bear all costs of soliciting Proxies. The solicitation of Proxies will be by mail, but Proxies may also be solicited by telephone, telegram, or in person by directors, officers, and other regular employees of the Company or of the Bank. Should the Company, in order to solicit Proxies, request the assistance of other financial institutions, brokerage houses, or other custodians, nominees, or fiduciaries, the Company will reimburse such persons for their reasonable expenses in forwarding proxy materials to Shareholders and obtaining their Proxies.

The Annual Report of the Company for the fiscal year ended December 31, 2006, incorporating the Form 10-K filed by the Company with the Securities and Exchange Commission, is being sent to Shareholders with this Proxy Statement.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS**

The following table provides information concerning all persons known by the Company to beneficially own 5% or more of the Company's outstanding stock.

<b>Name and Address of Beneficial Owner</b>	<b>Number of Shares of Common Stock Beneficially Owned</b>	<b>Percent of Class</b>
Dimensional Fund Advisors Inc. 1299 Ocean Avenue, 11 <sup>th</sup> Floor Santa Monica, CA 90401	2,452,752(1)	8.19%
Barclays Global Investors, NA/ Barclays Global Fund Advisors/ Barclays Global Investors, Ltd. 45 Freemont Street San Francisco, CA 94105	2,263,519(2)	7.56%

(1) Based solely on information contained in Schedule 13G/A filed with the Securities and Exchange Commission on February 9, 2007, Dimensional Fund Advisors LP ( Dimensional ) has sole voting power and sole dispositive power with respect to all shares listed. Dimensional is an investment advisor that

furnishes investment advice to four investment companies registered under the Investment Company Act of 1940, and serves as investment manager to certain other commingled group trusts and separate accounts (collectively, the Funds ). In its role as investment advisor or manager, Dimensional possesses investment and/or voting power over the Company s securities that are owned by the Funds, and may be deemed to be the beneficial owner of the shares held by the Funds. However, all securities reported in the Schedule 13G/A are owned by the Funds. Dimensional disclaims beneficial ownership of such securities.

- (2) Based solely on information contained in



Schedule 13G  
filed with the  
Securities and  
Exchange  
Commission on  
January 23,  
2007, Barclays  
Global Investors,  
NA, Barclays  
Global Fund  
Advisors, and  
Barclays Global  
Investors, Ltd.  
collectively have  
sole voting  
power with  
respect to  
2,156,856 shares  
and sole  
dispositive  
power with  
respect to all  
shares listed.

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**Table of Contents****ITEM ONE: ELECTION OF DIRECTORS AND INFORMATION WITH RESPECT TO DIRECTORS AND EXECUTIVE OFFICERS**

The first item to be acted upon at the Meeting is the election of three directors, each to hold office for three years and until his successor shall have been duly elected and qualified. Directors Nicholas A. DiCerbo, James A. Gabriel and Charles E. Parente, whose terms are scheduled to expire as of the date of the Meeting, will stand for re-election. Director Harold S. Kaplan, whose term of office expires as of the date of the Meeting, will not stand for re-election at the Meeting. The nominees receiving a plurality of the votes represented in person or by proxy at the Meeting will be elected directors.

All Proxies in proper form which are received by the Board prior to the election of directors at the Meeting will be voted FOR the nominees listed below, unless authority is withheld in the space provided on the enclosed Proxy. Each nominee is presently a director of the Company, and each director of the Company is also a director of the Bank. In the event any nominee declines or is unable to serve, it is intended that the Proxies will be voted for a successor nominee designated by the Board. All nominees have indicated a willingness to serve, and the Board knows of no reason to believe that any nominee will decline or be unable to serve if elected. The nine members of the Board whose terms will continue beyond the Meeting (including the nominees for election at the Meeting, if elected) are expected to continue to serve on the Board until their respective terms expire or until attainment of mandatory retirement age in accordance with the Company's bylaws.

The information set forth below is furnished for each nominee for director to be elected at the Meeting and each director of the Company whose term of office continues after the Meeting. The share ownership numbers for certain directors include shares that would be issuable upon exercise of Offset Options granted to these directors in order to reduce the Company's liability under its Stock Balance Plan. The purpose of the Offset Options is explained on page 13. See footnote (e) on page 7 for the number of currently exercisable stock options (including, without limitation, Offset Options) held by specific directors.

**NOMINEES FOR DIRECTOR AND DIRECTORS CONTINUING IN OFFICE**

Name and Age (a)	Director of the Company Since	Business Experience During Past Five Years (b)	Shares of Company Common Stock Beneficially Owned (c)	
			as of March 29, 2007 (d) Number(e)	Percent
<b>Nominees (for terms to expire at Annual Meeting in 2010):</b>				
Nicholas A. DiCerbo Age 60	1984	Partner, law firm of DiCerbo and Palumbo, Olean, New York.	295,538	.98%
James A. Gabriel Age 59	1984	Owner, law firm of Franklin & Gabriel, Ovid, New York.	169,331	.56%

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Name and Age (a)	Director of the Company Since	Business Experience During Past Five Years (b)	Shares of Company Common Stock Beneficially Owned (c)	
			as of March 29, 2007 (d) Number(e)	Percent
Charles E. Parente (f) Age 66	2004	Chief Executive Officer of Pagnotti Enterprises, Inc., a diversified holding company whose primary business includes workers compensation insurance, real estate, anthracite coal mining preparation and sales, and cable television.	266,699	.89%

**Directors Continuing in Office:****Terms expiring at Annual Meeting in 2008:**

Brian R. Ace (g) Age 52	2003	Owner, Laceyville Hardware, Laceyville, Pennsylvania.	69,043	.23%
Paul M. Cantwell, Jr. Age 65	2001	Owner, law firm of Cantwell & Cantwell, Malone, New York. Prior to January 2001, Chairman and President, The Citizens National Bank of Malone.	150,290	.50%
William M. Dempsey Age 68	1984	Retired. Prior to 2001, Assistant to the President, Rochester Institute of Technology, Rochester, New York; President/Dean, American College of Management and Technology (RIT), Dubrovnik, Croatia (August 1997 - July 1999); prior to August 1997, Vice President of Finance and Administration, RIT.	119,392	.40%

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Name and Age (a)	Director of the Company Since	Business Experience During Past Five Years (b)	Shares of Company Common Stock Beneficially Owned (c)	
			as of March 29, 2007 (d) Number(e)	Percent
<b>Terms expiring at Annual Meeting in 2009:</b>				
David C. Patterson Age 65	1991	President and owner of Wight and Patterson, Inc., manufacturer and seller of livestock feed located in Canton, New York.	131,245	.43%
Sally A. Steele (g) Age 51	2003	Attorney, self-employed as general practitioner with concentration in real estate and elder law, Tunkhannock, Pennsylvania.	68,842	.23%
Mark E. Tryniski Age 46	2006	President and Chief Executive Officer of the Company. From August 2004 through July 31, 2006, Executive Vice President and Chief Operating Officer of the Company. From March 2004 through July 2004, Executive Vice President, Chief Operating Officer and Chief Financial Officer of the Company. From July 2003 through February 2004, Executive Vice President and Chief Financial Officer of the Company. Prior to 2003, a partner at the accounting firm of PricewaterhouseCoopers LLP in Syracuse, New York.	41,108	.14%
<b>Director Not Continuing in Office:</b>				
Harold S. Kaplan (h) Age 73	2001	Co-owner, M.C.F., Inc., and Partner, D&T Real Estate, Scranton, Pennsylvania. Prior to April 2003, Co-Owner, Montage Foods, Inc., Scranton, Pennsylvania.	301,067	1.0%

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<b>Name and Age (a)</b>	<b>Director of the Company Since</b>	<b>Business Experience During Past Five Years (b)</b>	<b>Shares of Company Common Stock Beneficially Owned (c)</b>	
			<b>as of March 29, 2007 (d) Number(e)</b>	<b>Percent</b>
In addition to the information provided above, the following summarizes the security ownership of the highest paid executive officers during the fiscal year ended December 31, 2006 who are not also directors continuing in office or nominees:				
Scott A. Kingsley Age 42		Executive Vice President, Chief Financial Officer. Prior to August 2004, Vice President and Chief Financial Officer of Carlisle Engineered Products, Inc.	16,632	.06%
Brian D. Donahue Age 51		Executive Vice President and Chief Banking Officer	70,797	.23%
Thomas A. McCullough Age 60		President, Pennsylvania Banking. Prior to November 2003, President and Chief Executive Officer of Grange National Banc Corp.	8,142	.03%
J. David Clark Age 53		Senior Vice President and Chief Credit Officer	57,756	.19%
Sanford A. Belden Age 64		Retired; former Director, President and Chief Executive Officer	77,279	.26%
Michael A. Patton Age 61		Retired; former President, Financial Services	117,544	.39%
Number of shares of Company common stock beneficially owned by all directors, persons chosen to become directors and executive officers of the Company as a group (16 persons)			1,960,705	6.33%

(a) No family relationships exist between any of the aforementioned directors or executive

officers of the Company.

- (b) No nominee for director or continuing director of the Company holds a directorship with any company (other than the Company) which is registered pursuant to Section 12 or subject to the requirements of Section 15(d) of the Securities Exchange Act of 1934, or with any company which is a registered investment company under the Investment Company Act of 1940.
  
- (c) Represents all shares as to which named individual possessed sole or shared voting or investment power as of March 29, 2007. None of the shares are pledged as security. Includes shares held by, in the name of, or in trust for, spouse and dependent children of

named  
individual and  
other relatives  
living in the  
same household,  
even if  
beneficial  
ownership has  
been disclaimed  
as to any of  
these shares by  
the nominee or  
director.

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(d) The listed amounts include shares as to which certain directors and named executive officers are beneficial owners but not the sole beneficial owners as follows: Mr. Ace holds 3,828 shares jointly with his wife, his wife holds 117 shares, and 15,475 shares are held in the name of Laceyville Hardware, of which Mr. Ace is owner; Mr. Cantwell's wife holds 10,200 shares; Mr. Clark holds 3,300 shares with his wife and is the beneficial owner of 8,634 shares held by the Company's 401(k) Plan; Mr. DiCerbo holds 63,930 shares jointly with his wife, 94,223 shares are held in the name of the law partnership of DiCerbo and Palumbo, and his wife holds 1,793 shares; 12,587 shares are held by a charitable foundation of which Mr. Kaplan serves as



President,  
Treasurer, and  
Director;  
Mr. Donahue is  
the beneficial  
owner of 3,548  
shares held by the  
Company's 401(k)  
Plan;  
Mr. Kingsley is  
the beneficial  
owner of 593  
shares held by the  
Company's 401(k)  
Plan;  
Mr. McCullough  
holds 108 shares  
jointly with his  
wife, 630 shares  
jointly with his  
mother, and is the  
beneficial owner  
of 1,723 shares  
held by the  
Company's 401(k)  
Plan; Mr. Parente  
holds 16,000  
shares as Trustee  
of the C.E.  
Parente Trust  
U/A, his wife  
holds 3,000  
shares, and  
222,858 shares  
are held by a  
partnership  
controlled by  
Mr. Parente;  
Mr. Patterson  
holds 4,760  
shares jointly with  
his wife and 5,502  
shares as Trustee  
for the Wight and  
Patterson  
Retirement Plan;  
Mr. Patton's wife  
holds 2,800  
shares; Ms. Steele  
holds 38,122  
shares jointly with

her husband; and  
Mr. Tryniski is  
the beneficial  
owner of 740  
shares held by the  
Company's 401(k)  
Plan.

- (e) Includes shares that the following individuals currently have the right to acquire, or will have the right to acquire within 60 days of March 29, 2007, through exercise of stock options issued by the Company:
- Mr. Ace, 35,120 shares;
  - Mr. Belden, 76,279 shares;
  - Mr. Cantwell, 38,345 shares;
  - Mr. Clark, 37,802 shares;
  - Mr. Dempsey, 115,611 shares;
  - Mr. DiCerbo, 118,047 shares;
  - Mr. Donahue, 54,469 shares;
  - Mr. Gabriel, 98,417 shares;
  - Mr. Kaplan, 15,239; Mr. Kingsley, 12,543 shares;
  - Mr. McCullough, 4,769 shares;
  - Mr. Parente, 23,004 shares;
  - Mr. Patterson, 103,551 shares;
  - Mr. Patton, 64,830 shares;
  - Ms. Steele, 30,720 shares;

and Mr. Tryniski,  
25,920 shares.  
These shares are  
included in the  
total number of  
shares  
outstanding for  
the purpose of  
calculating the  
percentage  
ownership of the  
foregoing  
individuals and of  
the group as a  
whole, but not for  
the purpose of  
calculating the  
percentage  
ownership of  
other individuals  
listed in the  
foregoing table.

- (f) Pursuant to the terms of a Merger Agreement dated as of March 11, 2004 providing for the merger of First Heritage Bank with and into the Bank (which merger was consummated in May 2004), the Company agreed to appoint one of First Heritage Bank's former shareholders, Charles E. Parente, to serve as a member of the Company's Board of Directors for a term expiring at the 2007 Annual Shareholders Meeting. The Merger

Agreement further provided that, subject to the exercise of the Board's fiduciary duty, Mr. Parente would be nominated for at least one additional three-year term upon expiration of his initial term, and that the Board would recommend that the Company's Shareholders vote in favor of his re-election. Mr. Parente's nomination this year satisfied the Company's obligation with respect to nominating Mr. Parente to the Board pursuant to the Merger Agreement.

- (g) Pursuant to the terms of a Merger Agreement dated as of June 7, 2003 providing for the merger of Grange National Banc Corp. ( Grange ) with and into the Company (which merger was consummated in November 2003), the Company agreed to appoint two of Grange's former directors, Brian R. Ace and Sally A. Steele, to

serve as members of the Company's Board of Directors for terms expiring at the 2005 and 2006 annual Shareholders meetings, respectively. The Merger Agreement further provided that, subject to the exercise of the Board's fiduciary duty, Mr. Ace and Ms. Steele would be nominated for at least one additional three-year term upon expiration of these initial terms, and that the Board would recommend that the Company's Shareholders vote in favor of their re-election. Pursuant to the Merger Agreement, Mr. Ace and Ms. Steele were elected as members of its Board of Directors for additional terms expiring at the 2008 and 2009 Annual Shareholders Meetings, respectively.

- (h) Pursuant to the terms of a Merger Agreement dated

as of  
November 29,  
2000 providing  
for the merger of  
First Liberty Bank  
Corp. ( First  
Liberty ) with and  
into the Company  
(which merger  
was consummated  
in May 2001), the  
Company agreed  
to appoint three of  
First Liberty s  
former directors,  
Saul Kaplan,  
Peter A. Sabia,  
and Harold S.  
Kaplan, to serve  
as members of its  
Board of  
Directors for  
terms expiring at  
the 2002, 2003,  
and 2004 annual  
Shareholders  
meetings,  
respectively. The  
Merger  
Agreement  
further provided  
that, subject to the  
exercise of the  
Board s fiduciary  
duty,  
Messrs. Kaplan,  
Sabia, and Kaplan  
would be

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nominated for at least one additional three-year term upon expiration of these initial terms, and that the Board would recommend that the Company's Shareholders vote in favor of their re-election. Saul Kaplan's term of office expired as of the date of the 2005 Annual Meeting of Shareholders, and he did not stand for re-election.

Peter A. Sabia's term of office expired as of the date of the 2006 Annual Meeting of Shareholders, and he did not stand for re-election.

Harold S. Kaplan's current term of office will expire as of the date of the Meeting, and he will not stand for re-election.

**CORPORATE GOVERNANCE**

The Company maintains a corporate governance section on its website which contains our principal governance documents including the Company's Corporate Governance Guidelines, Codes of Conduct applicable to directors, executive officers and employees, the Company's Whistleblower Policy, and the Committee Charters for the Audit Committee, Compensation Committee, and the Nominating and Corporate Governance Committee. These corporate governance documents are available on our website at [www.communitybankna.com](http://www.communitybankna.com) under the heading "Corporate Information - Corporate Governance," and a copy will be provided to any shareholder who requests a copy from the Company.

**Director Independence**

The New York Stock Exchange ( NYSE ) listing standards and the Company s Corporate Guidelines require the Board of Directors to be comprised of at least a majority of independent directors. The Board has determined that 7 of the 9 directors nominated to serve on the Board or continuing in office after the Meeting are independent under the NYSE standards and the Company s Corporate Governance Guidelines.

For a director to be considered independent, the Board must determine that the director does not have any direct or indirect material relationship with the Company. To assist it in determining director independence, the Board uses categorical standards which conform to, or are more exacting than, the independence requirements in the NYSE listing standards. Under these standards, absent other material relationships, transactions or interests, a director will be deemed to be independent unless within the preceding three years: (i) the director was employed by the Company or received more than \$100,000 per year in direct compensation from the Company, other than director and committee fees and pension or other forms of deferred compensation payments for prior service, (ii) the director was a partner of or employed by the Company s independent auditor, (iii) the director is part of an interlocking directorate in which an executive officer of the Company serves on the Compensation Committee of another company that employs the director, (iv) the director is an executive officer or employee of another company that makes payments to, or receives payments from, the Company for property or services in an amount which, in any fiscal year, exceeds the greater of one million dollars or 2% of the other company s consolidated gross revenues, or (v) the director had an immediate family member in any of the categories in (i) (iv). In determining whether a director is independent, the Board relies on the stated categorical standards but also considers whether a director has any direct or indirect material relationships, transactions or interests with the Company that might be viewed as interfering with the exercise of his or her independent judgment.

Based on these independence standards, the Board of Directors determined that the following individuals who served as directors during all or part of the last fiscal year were independent directors during their service on the Board during such year: Brian R. Ace, John M. Burgess, Paul M. Cantwell, Jr., William M. Dempsey, James A. Gabriel, Lee T. Hirschey, Harold S. Kaplan, Charles E. Parente, David C. Patterson, Peter A. Sabia and Sally A. Steele.



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In reviewing the independence of Paul M. Cantwell, Jr., James A. Gabriel and Sally A. Steele, the Board considered the transactions described in the section entitled Transactions with Related Parties on pages 13-14, including the legal services provided by law firms in which the directors have a direct or indirect material interest and determined that the relationships disclosed would not interfere with the exercise of the director's independent judgment.

Pursuant to the Company's Corporate Governance Guidelines, the independent directors meet in executive session at least quarterly, without the Company's management and non-independent directors present. The director who presides over these executive sessions is determined by the Board on the recommendation of the Nominating and Corporate Governance Committee.

**Board Committees**

Among its standing committees, the Board of the Bank has an Audit/Compliance/Risk Management Committee which also serves as the Company's Audit Committee. As described more fully on page 39, the Audit/Compliance/Risk Management Committee reviews internal and external audits of the Company and the Bank and the adequacy of the Company's and the Bank's accounting, financial, and compliance controls, and investigates and makes recommendations to the Company's Board and the Bank's Board regarding the appointment of independent auditors. The Audit/Compliance/Risk Management Committee held eight meetings during 2006, and its present members are Directors William M. Dempsey (Chair), Brian R. Ace, and Charles E. Parente.

The Bank's Board also has a Compensation Committee which reviews and makes recommendations to the Bank's Board regarding compensation adjustments and employee benefits to be instituted, and which also serves as the Company's Compensation Committee. As described more fully on page 15, the Compensation Committee reviews the compensation of nonofficer employees in the aggregate, and the salaries and performance of executive officers are reviewed individually. The Compensation Committee held seven meetings in 2006, and its present members are Directors Brian R. Ace (Chair), Charles E. Parente, David C. Patterson, and Sally A. Steele.

The Company has a Nominating and Corporate Governance Committee which makes recommendations to the Board for nominees to serve as directors. The Nominating and Corporate Governance Committee held seven meetings in 2006, and its present members are Directors Sally A. Steele (Chair), Brian R. Ace, William M. Dempsey, James A. Gabriel, and David C. Patterson. The Board has determined that each of the Nominating and Corporate Governance Committee's members is independent as defined by the NYSE Rules.

The Nominating and Corporate Governance Committee will consider written recommendations from Shareholders for nominees to serve on the Board that are sent to the Secretary of the Company at the Company's main office. In considering candidates for the Board, the Nominating and Corporate Governance Committee and the Board consider the entirety of each candidate's credentials and do not have any specific minimum qualifications that must be met by a nominee. Factors considered include, but are not necessarily limited to, outstanding achievement in a candidate's personal career; broad experience; wisdom; integrity; ability to make independent, analytical inquiries; understanding of the business environment; and willingness to devote adequate time to Board duties. The Board believes that each director should have a basic understanding of (i) the principal operational and financial objectives and plans and strategies of the Company, (ii) the results of operations and financial condition of the Company and of any significant subsidiaries or business segments, and (iii) the relative standing of the Company and its business segments in relation to its competitors. Prior to nominating an existing director for re-election to the Board, the Board and the Nominating and Corporate Governance Committee consider and review, among other relevant factors, the existing director's meeting attendance and performance, length

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of Board service, ability to meet regulatory independence requirements, and the experience, skills, and contributions that the director brings to the Board. The Nominating and Corporate Governance Committee has adopted a written charter setting forth its composition and responsibilities, a copy of which is available at the Company's website at [www.communitybankna.com](http://www.communitybankna.com) and in print to any Shareholder who requests it.

Mr. Cantwell, as Chair of the Board, serves as a member of all Board Committees. The President and Chief Executive Officer of the Company serves as a non-voting ex officio member of all Board committees except the Audit/Compliance/Risk Management Committee, the Compensation Committee, and the Nominating and Corporate Governance Committee, and receives no compensation for serving in this capacity.

**Communication with Directors**

Shareholders and any interested parties may communicate directly with the Board of the Company by sending correspondence to the address shown below. The receipt of any such correspondence addressed to the Board and the nature of its content will be reported at the next Board meeting and appropriate action, if any, will be taken. If a Shareholder or an interested party desires to communicate with a specific director, the correspondence should be addressed to that director. Correspondence addressed to a specific director will be delivered to the director promptly after receipt by the Company. The director will review the correspondence received and, if appropriate, report the receipt of the correspondence and the nature of its content to the Board at its next meeting, so that the appropriate action, if any, may be taken.

Correspondence should be addressed to:

Community Bank System, Inc.

Attention: [Board of Directors or Specific Director]

5790 Widewaters Parkway

DeWitt, New York 13214-1883

**Compensation of Directors**

As directors of both the Company and the Bank, Board members receive an annual retainer of \$10,000, \$750 for each Board meeting they attend, and \$500 for each committee meeting they attend. The executive officer serving on the Board does not receive an annual retainer or compensation for attending Board and committee meetings. The Chair of the Board receives an all inclusive \$55,000 retainer for serving in that capacity. The Chair of the Audit/Compliance/Risk Management Committee receives an annual retainer of \$5,000; the Chairs of the Loan/ALCO Committee, the Compensation Committee, and the Strategic/Executive Committee each receive an annual retainer of \$3,500; and the Chairs of the Nominating and Corporate Governance Committee, and the Trust Committee each receive an annual retainer of \$1,000. The Company pays the travel expenses incurred by each director in attending meetings of the Board.

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The Company does not make payments (or have any outstanding commitments to make payments) to director legacy programs or similar charitable award programs. The following table summarizes the annual compensation paid to each non-employee director for his or her service to the Board and its committees in 2006.

**DIRECTOR COMPENSATION**

Name (1)	Fees Earned or Paid in Cash	Option Awards (\$ (2)	Change in Pension Value and Nonqualified Deferred Compensation	
			Earnings (3)	Total(\$)
Brian R. Ace	\$43,250	\$20,198	\$11,630	\$75,078
John M. Burgess (4)	\$41,000	\$20,198	\$24,668	\$85,866
Paul M. Cantwell	\$43,000	\$20,198	\$13,495	\$76,693
William M. Dempsey	\$39,500	\$20,198	\$28,076	\$87,774
Nicholas A. DiCerbo	\$45,250	\$20,198	\$26,031	\$91,479
James A. Gabriel	\$45,000	\$20,198	\$28,076	\$93,274
Lee T. Hirschey (4)	\$36,500	\$20,198	\$24,668	\$81,366
Harold S. Kaplan (4)	\$28,500	\$20,198	\$12,855	\$61,553
Charles E. Parente	\$47,000	\$20,198	\$11,630	\$78,828
David C. Patterson	\$47,500	\$20,198	\$26,031	\$93,729
Peter A. Sabia (4)	\$21,667	\$20,198	\$ 0	\$41,865
Sally A. Steele	\$43,500	\$20,198	\$11,630	\$75,328

(1) Mark E. Tryniski, President and Chief Executive Officer, does not receive any compensation for his service as a director. Mr. Tryniski's compensation is set forth in the Summary Compensation Table on page 24. Sanford A. Belden, the retired President, Chief Executive Officer and Director of the Company, did not receive any compensation for his service as a director. Mr. Belden's

compensation is set forth in the Summary Compensation Table.

- (2) The amounts in this column reflect the dollar amount recognized for financial statement reporting purposes for the fiscal year ended December 31, 2006, in accordance with FAS 123R of stock option awards granted in 2006 pursuant to the Company's 2004 Long-Term Incentive Compensation Program. The options vest immediately upon grant and the exercise price is \$23.74. As of December 31, 2006, each Director has the following number of options outstanding:
- |              |          |
|--------------|----------|
| Mr. Ace      | 40,297;  |
| Mr. Burgess  | 26,836;  |
| Mr. Cantwell | 34,528;  |
| Mr. Dempsey  | 111,794; |
| Mr. DiCerbo  | 114,230; |
| Mr. Gabriel  |          |

106,218;  
Mr. Hirschey  
17,022;  
Mr. Kaplan  
11,422;  
Mr. Parente  
19,187;  
Mr. Patterson  
99,734;  
Mr. Sabia 6,902;  
and Ms. Steele  
26,903.

- (3) The amounts in this column represent the aggregate change in the actuarial present value of the Director's Stock Balance Plan, a nonqualified plan. No earnings are deemed above-market or preferential on compensation deferred under the Deferred Compensation Plan for the Directors. Under the Deferred Compensation Plan, a director may choose to have his or her retainer and committee fees deferred until his or her membership on the Board ends. Contributions are deemed to be invested in the Company's common stock which is deemed

to earn dividends  
at the same rate  
as the Company  
pays actual  
dividends on  
actual shares.

- (4) Effective as of  
the 2006 Annual  
Meeting held on  
May 16, 2006,  
Messrs. Belden  
and Sabia retired  
from the Board.  
Effective  
December 31,  
2006,  
Messrs. Burgess  
and Hirschey  
retired from the  
Board pursuant  
to the Company's  
mandatory  
retirement policy  
for directors.  
Pursuant to the  
Company's  
Bylaws, a  
director is  
required to retire  
from the Board  
on  
December 31st  
of the year in  
which he or she  
attains the age of  
70. As more  
fully described  
in footnote  
(h) on pages 7-8,  
Mr. Kaplan will  
retire from the  
Board effective  
as of the 2007  
Annual Meeting.

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Directors may elect to defer all or a portion of their director fees pursuant to a deferred compensation plan for Directors. Directors who elect to participate in the plan designate the percentage of their director fees which they wish to defer (the deferred fees ) and the date to which they wish to defer payment of benefits under the plan (the distribution date ). The plan administrator establishes an account for each participating director and credits to such account (i) on the date a participating director would have otherwise received payment of his or her deferred fees, the number of deferred shares of Company common stock which could have been purchased with the deferred fees, and (ii) from time to time such additional number of deferred shares which could have been purchased with any dividends which would have been received had shares equal to the number of shares credited to the account actually been issued and outstanding. On the distribution date, the participating director shall be entitled to receive shares of Company common stock equal to the number of deferred shares credited to the director s account either in a lump sum or in annual installments over a three, five or ten year period. The effect of the plan is to permit directors to invest deferred director fees in stock of the Company, having the benefit of any stock price appreciation and dividends as well as the risk of any decrease in the stock price. To the extent that directors participate in the plan, the interests of participating directors will be more closely associated with the interests of Shareholders in achieving growth in the Company s stock price.

Consistent with aligning director compensation with the long-term interests of Shareholders, the Company s 2004 Long-Term Incentive Compensation Program (the 2004 Incentive Plan ) allows for the issuance of Non-Statutory Stock Options to nonemployee directors. In particular, when directors receive equity-based compensation such as stock options, their overall compensation is enhanced when the market price of the Company s common stock increases and is adversely affected when the market price of the Company s common stock decreases. The Board believes that providing Non-Statutory Stock Options to nonemployee directors is consistent with the Company s overall compensation philosophy by more closely aligning the interests of individual directors with the long-term interests of the Company s Shareholders, and enabling the Company to continue to attract qualified individuals to serve on the Board.

Under the 2004 Incentive Plan, each eligible nonemployee director is entitled to receive an option to purchase shares of common stock on or about January 1st of his or her first year as a director, and an option to purchase shares on or about the date of the January Board meeting each year thereafter. Each option granted to a nonemployee director is granted at an option price per share equal to the market value per share of the Company s common stock on the date of grant, and is fully exercisable on its date of grant, provided that shares of common stock acquired pursuant to the exercise of such options may not be sold or otherwise transferred by a director within six months of the grant. Each option remains exercisable after the grant date until the earlier of (i) ten years from the date of grant, or (ii) termination of the optionee s service on the Board for cause (as defined in the 2004 Incentive Plan). Notwithstanding the foregoing, to the extent that the Committee appointed by the Board to administer the 2004 Incentive Plan determines that grants may be exempt from Section 16(b) of the Securities Exchange Act of 1934, as amended, the Non-Statutory Stock Options granted to eligible nonemployee directors shall relate to a number of shares of common stock to be determined based upon the financial performance of the Company. Such financial performance shall be determined based upon factors including (but not limited to) the Company s growth in earnings per share, asset quality, return on equity, and CAMELS rating (a measurement of capital, assets, management, earnings, liquidity, and sensitivity utilized by the Office of the Comptroller of the Currency, the Bank s primary regulator). Pursuant to the 2004 Incentive Plan, each eligible nonemployee director received an option to purchase 3,298 shares effective January 18, 2006.

In addition, in keeping with the objective of aligning director compensation with the long-term interests of Shareholders, effective January 1, 1996, the Board adopted a Stock Balance Plan for nonemployee directors of the Company who have completed at least six months of service as director. The plan establishes an account for each eligible director. Amounts credited to those accounts reflect the

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value of 400 shares of the Company's common stock for each year of service between 1981 and 1995 at the December 31, 1995 market value, plus an annual amount equal to 400 additional shares of common stock beginning in 1996, plus an annual earnings credit equal to the most recent year's total return on the Company's common stock. The crediting of additional units beginning in 1996 is subject to an adjustment factor which reflects the Company's asset quality, return on equity, and CAMELS rating. Each director's account balance is vested after six years of service and is payable in the form of a lifetime annuity or, at the election of the director, monthly installment payments over a three, five, or ten year period following the later of age 55 or disassociation from the Board and is forfeitable in the event of termination from the Board for cause.

The 2004 Incentive Plan allows the grant of Offset Options to directors. The effect of these Offset Options is to permit the Company to reduce the grantee's Stock Balance Plan account balance by an amount equal to the growth in value of the Offset Options (i.e., the amount by which the aggregate fair market value of the common stock underlying the Offset Options exceeds the aggregate exercise price of the Offset Options) as of the date on which the director's account is valued, provided that a director's account may not be reduced below zero. As such, the Offset Options are not intended to materially change the level of compensation to participating directors under the Stock Balance Plan, but are intended to reduce the cost of director compensation to the Company. In the event that the growth in value of a director's Offset Options is less than the value of the director's Stock Balance Plan account, the shortfall will be paid to the director in cash. In the event that the growth in value of a director's Offset Options exceeds the value of the director's Stock Balance Plan account, no payment will be made.

**Transactions With Related Parties**

Various directors, executive officers and other related parties of the Company and the Bank (and members of their immediate families and corporations, trusts, and other entities with which these individuals are associated) are indebted to the Bank through business and consumer loans offered in the ordinary course of business by the Bank. All such loans were made in the ordinary course of business, were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the Bank, and did not involve more than the normal risk of collectability or present other unfavorable features. The Company expects that the Bank will continue to have banking transactions in the ordinary course of business with its directors, executive officers and other related parties on substantially the same terms, including interest rates and collateral, as those then prevailing for comparable transactions with others.

During the year ended December 31, 2006, the law firm of Franklin & Gabriel, owned by director James A. Gabriel, provided legal services to the Bank's operations in its Finger Lakes markets; the law firm of DiCerbo and Palumbo, of which director Nicholas A. DiCerbo is a partner, provided legal services to the Bank's operations in its Southern Region markets; the law firm of Cantwell & Cantwell, owned by Director Paul M. Cantwell, Jr., provided legal services to the Bank's operations in its Northern Region markets; and director Sally Steele provided legal services and related residential loan closing services through her law firm and related entities to the Bank's operations in its Pennsylvania markets. All of these relationships and transactions relate to the provision of legal services in connection with, and in support of, the Bank's lending business in local and regional markets where the law firms are established and well-recognized in the communities. For services rendered during 2006 and for related out-of-pocket disbursements, the law firm of DiCerbo & Palumbo received approximately \$296,977 for transactional and specialized commercial legal services performed for the Bank and related loan closings with customers of the Bank, and Sally A. Steele received approximately \$116,400 for legal services performed for the Bank and related loan closings handled by her law firm and entities with which she is affiliated (approximately \$29,950 relates to payments to Ms. Steele's law firm and approximately \$88,450 relates to entities with which she is affiliated). During 2006, the firms of Franklin & Gabriel and Cantwell &



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Cantwell received less than \$100,000 for services performed for the Bank and related to loan closings in the relevant market area. These relationships are expected to continue in 2007 subject to review of such relationships in accordance with the Company's policies. Pursuant to the terms of its written charter, the Audit Committee is responsible for reviewing and approving related party transactions involving the Company or the Bank.

The Board of Directors has recently adopted a written policy, to be administered by the Audit Committee, which provides procedures for the review of related party transactions involving directors, executive officers, director nominees, and other related parties. In deciding whether to approve such related party transactions, the Audit Committee will consider, among other factors it deems appropriate, whether the transaction is on terms comparable to those generally available to nonaffiliated parties and is consistent with the best interests of the Company. For purposes of this policy, a related party transaction is a transaction, arrangement, or relationship or series of similar transactions, arrangements or relationships in which (i) the Company or one of its subsidiaries is involved, (ii) the amount involved exceeds \$100,000 in any calendar year, and (iii) a related party has a direct or indirect material interest. Related parties include executive officers, directors, director nominees, beneficial owners of more than 5% of the Company's stock, immediate family members of any of the forgoing persons, and any firm, corporation or other entity in which any of the forgoing persons has a direct or indirect material interest.

**Compensation Committee Interlocks and Insider Participation**

Brian R. Ace, Lee T. Hirschey (retired), Charles E. Parente, David C. Patterson and Sally A. Steele served on the Compensation Committee during 2006. There were no Compensation Committee interlocks or insider (employee) participation during 2006.

**Director Meeting Attendance**

The Board of Directors held 12 regularly scheduled meetings and four special meetings during the fiscal year ended December 31, 2006. During this period, each director of the Company attended at least 75% of the aggregate of the total number of meetings of the Board and the total number of meetings held by committees of the Board on which he or she served.

The Company encourages all directors to attend each Annual Meeting of Shareholders. All of the then 12 incumbent directors attended the Company's last Annual Meeting of Shareholders held on May 16, 2006.

**Code Of Ethics**

The Company has a Code of Ethics for its directors, officers and employees. The Code of Ethics requires that individuals avoid conflicts of interest, comply with all laws and other legal requirements, conduct business in an honest and ethical manner, and otherwise act with integrity and in the best interests of the Company. In addition, the Code of Ethics requires individuals to report illegal or unethical behavior they observe.

The Company also has adopted a Code of Ethics for Senior Executive Officers that applies to its chief executive officer, chief financial officer, and other senior officers performing similar functions. This Code of Ethics is intended to promote honest and ethical conduct, full and accurate reporting, and compliance with laws and regulations.

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The text of each Code is posted on the Company's website at [www.communitybankna.com](http://www.communitybankna.com) and is available in print to any Shareholder who requests it. The Company intends to report and post on its website any amendment to or waiver from any provision in the Code of Ethics for Senior Executive Officers as required by SEC rules.

**COMPENSATION OF EXECUTIVE OFFICERS**

**Introduction**

The executive officer compensation information in this section is presented in a new format this year. The Securities and Exchange Commission adopted new executive compensation disclosure rules which require the following Compensation Discussion and Analysis ( CD&A ) section to explain the Company's compensation policy, the material elements of the total compensation paid to the Company's executive officers under such policy, and how the Company determines the amounts paid to such officers.

**The Role of the Compensation Committee**

The Board has established the Compensation Committee to address matters relating to employment, compensation and management performance. The Compensation Committee reviews and administers the Company's compensation policies and practices for the Named Executives (as defined below). The Compensation Committee consists of four members of the Board, each of whom is: (a) considered independent under the independence requirements of the New York Stock Exchange listing standards and any other applicable laws, rules and regulations governing independence; (b) qualified as a non-employee director, as defined under Section 16 of the Securities Exchange Act of 1934, as amended; and (c) qualified as an outside director under Section 162(m) of the Internal Revenue Code.

The Compensation Committee has authority to set the level of executive compensation. After extensive discussion and analysis, the Committee presents its recommendations to the Board for its approval. The Compensation Committee does not delegate its duties to any other person; however, it does work with management to structure the Named Executives' performance goals. The Company's Chief Human Resources Officer and the Human Resources staff supports the Compensation Committee's work by providing information reports to the Compensation Committee. Prior to the beginning of each fiscal year, the Compensation Committee discusses the Company's performance and sets future performance goals with the President and Chief Executive Officer.

In addition to working with Human Resources, the Compensation Committee has engaged the Banking Practice Group of Clark Consulting to assist the Compensation Committee with:

designing a long-term incentive program for its executive officers;

updating peer group data that the Compensation Committee uses to analyze executive officer compensation;  
and

making recommendations to better correlate pay and performance and to improve the competitiveness of executive officer compensation.

The Compensation Committee has adopted a written Charter, a copy of which is available at the Company's website [www.communitybankna.com](http://www.communitybankna.com) and in print to any person who requests a copy.

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**COMPENSATION DISCUSSION AND ANALYSIS**

*The following compensation discussion and analysis contains statements regarding future performance targets and goals for the Company's executives. These targets and goals are disclosed in the limited context of the Company's compensation program and should not be understood to be statements of management's expectations or estimates of results or other guidance. The Company specifically cautions investors not to apply these statements to any other context.*

**Philosophy and Objectives**

The Company's ability to hire and retain employees and executives with the requisite skills and experience to develop, expand and execute business opportunities is essential to its success and the success of its Shareholders. The Company recognizes that its employees have a choice regarding where they pursue their careers and therefore strives to provide a rewarding work environment. The Company seeks to deliver fair and competitive compensation to its employees by structuring compensation principally around two general goals. First, compensation is targeted to be near the median of the market. Second, employees are rewarded for satisfying goals designed to achieve growth in the Company's earnings. As a result, selected elements of its compensation program are tied to the achievement of individual and/or Company performance goals.

The Compensation Committee structures the elements of the total compensation program to achieve the objectives set forth above. In addition, and upon the recommendation of management, the Compensation Committee structures the annual cash incentive and equity-based elements of the compensation program to promote the achievement of the Company's long-term growth goals, including targeted earnings per share (EPS) each year. EPS is generally defined as the Company's net income divided by the weighted average number of shares outstanding during that period. EPS reflects the best measurement of the Company's performance and progress towards continuously increasing Shareholder value.

The Company's compensation program seeks to:

1. Attract, retain and motivate highly qualified executives through both short-term and long-term incentives that reward individual and Company performance;

2. Provide incentives to increase Shareholder value by:

structuring compensation contingent on performance measures intended to reward performance the Company believes creates Shareholder value, and

utilizing equity-based compensation to more closely al