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HAMMERMILL PAPER COMPANY
Notice of Annual Meeting

To Stockholders:

The Annual Meeting of Stockholders of Hammermill Paper Company will be held at the office of the Company, East Lake Road, Erie, Pennsylvania, on Tuesday, May 12, 1981 at 9:30 a.m. Eastern Daylight Saving Time to act upon the following matters:

1. Elect three directors to serve for a term of three years each; one director to serve for a term of two years; one director to serve for a term of one year; each to serve until his successor is elected and qualifies;
2. Approve an amendment to the Hammermill Thrift Plan.
3. Adopt the Hammermill Stock Option Plan of 1982;
4. Transact such other business as may properly come before the meeting or any adjournment thereof.

Only holders of Common Stock and Second Cumulative Preferred Stock, \$5.00 Series A (Convertible), of record at the close of business on March 24, 1981 will be entitled to notice of and to vote at the meeting.

HAMMERMILL PAPER COMPANY
by R. J. Kilgore, Secretary

Erie, Pennsylvania
April 6, 1981

YOUR VOTE IS IMPORTANT

Whether or not you plan to attend the meeting in person, please sign and date the enclosed form of proxy and return it in the enclosed postage paid envelope.

HAMMERMILL PAPER COMPANY

Executive Offices

1540 East Lake Road, Erie, Pennsylvania 16533

Proxy Statement

This proxy statement is furnished in connection with the solicitation by the Board of Directors of Hammermill Paper Company of proxies to be voted at the annual meeting of the stockholders of the Company which has been scheduled for Tuesday, May 12, 1981, and any adjournment or adjournments thereof. The shares represented by each proxy received by the Company in the enclosed form will be voted as specified by the stockholder on the proxy. If no such specification is made, such shares will be voted for the election of the nominees named below as Directors of the Company. If one or more of such nominees should be unable or unwilling to serve as a Director for any reason, such shares will be voted for a substitute nominee as may be chosen by the Board of Directors. The Company is unaware of any reason why any of the nominees would be unwilling or unable to serve if elected. Any such proxy may be revoked at any time before its exercise by giving notice of revocation to the Secretary of the Company, by submitting a later-dated proxy or by voting in person at the meeting.

Only holders of the Company's Common Stock and Second Cumulative Preferred Stock of record at the close of business on March 24, 1981 are entitled to notice of and to vote at the meeting. The holders of Second Cumulative Preferred and Common Stock are entitled to vote together and not as separate classes. On March 24, 1981 the Company had outstanding 83,312 shares of Second Cumulative Preferred Stock and 8,008,983 shares of Common Stock. In the election of Directors these shares have cumulative voting rights which means for each share held you may cast one vote for each Director to be elected, or cast all such votes for one Director, or distribute them as you may prefer. Each class of Directors to be elected at the meeting shall be elected in a separate election. Accordingly, each share has three votes in the election of the three Directors to the class being elected to a three-year term and each share has one vote in the election of one Director to a two-year term as well as one Director to a one-year term. Unless otherwise specified on the proxy, a vote for the nominees named below will grant discretionary authority to cumulate votes in the judgment of the persons named as proxies. Each share is entitled to one vote on any other matter.

Following the original mailing of proxy soliciting material, executive and other employees of the Company may solicit proxies by mail, telephone, telegraph and personal interview. Arrangements may also be made with brokerage houses and other custodians, nominees and fiduciaries which are record holders of the Company's stock to forward proxy soliciting material and annual

reports to the beneficial owners of such stock, and the Company may reimburse such record holders for their reasonable expenses incurred in such forwarding. The cost of soliciting proxies in the enclosed form will be borne by the Company.

It is expected that this proxy statement and the accompanying form of proxy will be mailed to stockholders on or about April 6, 1981. The Annual Report of the Company for the year 1980 has been mailed to stockholders.

MATTERS TO BE VOTED AT THE ANNUAL MEETING

1. ELECTION OF DIRECTORS

Three Directors are to be elected for a term of three years each and until their successors are elected and qualify. One Director is to be elected for a term of two years and until his successor is elected and qualifies and one Director is to be elected for a term of one year and until his successor is elected and qualifies (1) Information regarding these nominees is set forth below.

Name and Principal Occupation	Age	Director Since	If Elected, Term to Expire in
Bernard S. Kubale Partner, Foley & Lardner, Attorneys-at-Law, 777 East Wisconsin Avenue, Milwaukee, Wisconsin 53202, a director of George Banta Company, Inc., The Larsen Company, Mirro Corporation, Schultz Sav-O Stores, Inc., Wisconsin Finance Corporation. Foley & Lardner performs legal services for a division of the Company	52	1969	1984
William G. Kuhns Chairman and Chief Executive Officer, General Public Utilities Corporation, 100 Interpace Parkway, Parsippany, N.J. 07054, an electric utility holding company, a director of General Public Utilities Corporation, Marine Midland Banks, Inc., Home Life Insurance Company of New York	58	1975	1984
Donald S. Leslie, Jr. Executive Vice President of the Company, 1540 East Lake Road, Erie, Pa. 16533; a director of Lord Corporation, The First National Bank of Pennsylvania	55	1962(2)	1984
Fred Herbolzheimer, Jr.(3) Senior Vice President of the Company and President, Thilmany Pulp & Paper Company, P.O. Box 190, Kaukauna, Wisconsin 54130, a division of the Company	59	1974	1983

Roger S. Ahlbrandt (3)	69	1972	1982
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Chairman of the Executive Committee, Allegheny Ludlum Industries, Inc., 2200 Two Oliver Plaza, Pittsburgh, Pa. 15222, a multi-national, multi-product specialty manufacturing company; a director of Allegheny Ludlum Industries, Inc., Moore McCormack Resources, Inc., Equitable Gas Company

- (1) Though Directors of more than one class are to be elected, each class of Directors to be elected at the meeting shall be elected in a separate election pursuant to Section 403 of the Business Corporation Law of Pennsylvania.
- (2) Mr. Leslie has been an officer of the Company for more than the last five years and served as a Director of the Company from 1962 until May 1980.
- (3) Mr. Ahlbrandt is to be elected for a term to expire in 1982 and Mr. Herbolzheimer is to be elected for a term to expire in 1983 so as to create an equal number in each class of Directors in accordance with the Business Corporation Law of Pennsylvania.

The terms as Directors of the following four persons will continue after the annual meeting and will expire in 1982 and 1983. Information regarding these Directors is set forth below.

Name and Principal Occupation	Age	Director Since	Term to Expire in
Henry Curtis Chairman of the Board, American Business Products, Inc., Suite 500, 2690 Cumberland Parkway, Atlanta, Ga. 30039, a producer of printed business supplies; a director of American Business Products, Inc., Consolidated Equities Corp.	62	1974	1983
Albert F. Duval President and Chief Executive Officer of the Company, 1540 East Lake Road, Erie, Pa. 16533, a director of Milton Bradley Company, National Fuel Gas Company and Security Bank.	60	1962	1983
Louis H. Roddis, Jr. Consulting Engineer, 110 Broad Street, Charleston, S.C. 29401, a director of Gould, Inc., Research-Cottrell, Inc.	62	1964	1982
Charles M. Williams George Gund Professor of Commercial Banking, Graduate School of Business Administration, Harvard University, Cambridge, Mass. 02138, a director of Southern Natural Resources Inc., U. S. Leasing International, Inc., San Francisco Real Estate Investors, Massachusetts Companies, Merrill Lynch Institutional Fund, Merrill Lynch Government Fund, Fort Dearborne Income Fund, National Life Insurance Co. of Vermont.	63	1967	1982

Committees of the Board

The Board of Directors has standing Audit, Compensation and Executive Committees. It has no Nominating Committee. The Audit Committee reviews the scope of the annual audit and any material matters of accounting policy pertinent to their current year's accounts and reviews the results of the audit, and the sufficiency of internal accounting and auditing controls. The members of the Audit Committee are Messrs. Kubale, Roddis and Ahlbrandt. The Audit Committee met 3 times during 1980. The Compensation Committee recommends to the Board of Directors the amount and form for all compensation of elected officers of the Company. It also acts as the Stock Option Committee. The members of the Compensation Committee are Messrs. Curtis, Kuhns and Williams. The Compensation Committee met 3 times during 1980. The Executive Committee exercises delegable powers of the Board of Directors of the Company between meetings of the Board. The members of the Executive Committee are Messrs. Duval, Ahlbrandt and Kubale. The Committee met 8 times during 1980.

Meetings of the Board

Seven meetings of the full Board of Directors were held during 1980. Each Director attended all of the 1980 meetings of the Board, which he was eligible to attend, except Mr. Curtis who missed one meeting and Messrs. Kuhns and Williams each of whom missed two meetings.

EXECUTIVE OFFICERS

The executive officers of the Company, in addition to the officers who are expected to continue as Directors, or are nominees for Directors, are as follows:

<u>Name and Position with the Company (1)</u>	<u>Age</u>
Donald P. Boyd, Vice President	60
Richard W. Brown, Vice President	60
Robert J. Kilgore, Vice President, Secretary and General Counsel	55
Richard M. Ludwig, Vice President	49
W. Craig McClelland, Senior Vice President	46
Rollin O. Smith, Vice President and Controller	56
James S. Stolley, Senior Vice President; a director of General Telephone Company of Pennsylvania (wholly-owned subsidiary of G.T.E.)	52
Peter G. Volanakis, Senior Vice President, a director of Wm. E. Wright Co. and Marine Bank	60
Douglas C. Wright, Jr., Vice President—Finance and Treasurer, a director of Union Bank and Trust Co.	46

- (1) Each person named above has been employed by the Company for at least five years. Their principal business address is 1540 East Lake Road, Erie, Pa. 16533. All officers of the Company serve as such at the pleasure of the Board of Directors, although some have employment contracts with the Company. See "Management Remuneration."

MANAGEMENT REMUNERATION

The following information is furnished as the remuneration attributable to 1980 and paid by the Company to each of the five most highly compensated executive officers or Directors of the Company whose total 1980 remuneration exceeded \$50,000 and all officers and Directors of the Company as a group.

Name of individual or persons in group	Capacities in which served	Cash and cash-equivalent forms of remuneration		Aggregate of contingent forms of remuneration (3)
		Salaries, fees, Directors' fees, and bonuses (1)	Securities or property, insurance benefits or reimbursement, personal benefits (2)	
Albert F. Duval	Director, President and Chief Executive Officer	311,241	11,024	7,585
Fred Herbolzheimer, Jr.	Director, Senior Vice President of the Company and President of Thilmany Pulp & Paper Company, a division of the Company	134,672	6,334	4,014
Donald S. Leslie, Jr.	Executive Vice President	204,381	8,078	5,285
James S. Stolley	Senior Vice President	136,110	6,179	3,844
Peter G. Volanakis	Senior Vice President	167,364	6,683	4,352
All Officers and Directors as a group (19 persons)		1,864,394	78,533	47,550

- (1) Includes, among other things, awards, under the Company's Executive Performance Plan, attributable to 1980 but paid in 1981, and fees for serving on the Board of Directors or on Committees of the Board. Directors who are not employed by the Company are paid an annual retainer of \$11,000 plus \$1,000 for each Board meeting and \$500 for each Committee meeting they attend. Directors who are employees of the Company are not compensated as Directors.

- (2) This column represents the cost of premiums paid by the Company on certain group life and medical health insurance.
- (3) Includes amounts contributed by the Company under the Hammermill Thrift Plan, a savings plan for eligible salaried employees, and amounts contributed by the Company under the Hammermill Stock Ownership Plan, commonly known as a "TRASOP". Refer to page 11 for description of the Thrift Plan and to page 8 for description of the Stock Ownership Plan or TRASOP. Since January 1, 1976, the total amount of the Company's contribution under the Thrift Plan for certain Directors and officers and all present Directors and officers as a group has been as follows: \$25,244 for A. F. Duval, \$9,988 for F. Herbolzheimer, Jr., \$16,763 for D. S. Leslie, Jr., \$11,259 for J. S. Stolley, \$13,086 for P. G. Volanakis and \$139,642 for all Directors and officers as a group (13 Directors and officers). Since January 1, 1976, the total amount of the Company's contribution under the Stock Ownership Plan or TRASOP for certain Directors and officers and all present Directors and officers as a group has been as follows: \$3,425 for A. F. Duval, \$3,135 for F. Herbolzheimer, Jr. \$3,425 for D. S. Leslie, Jr., \$2,958 for J. S. Stolley, \$3,353 for P. G. Volanakis and \$34,100 for all Directors and officers as a group (13 Directors and officers).

Each of Messrs. Duval, Herbolzheimer, Kilgore, Leslie, Stolley and Volanakis has an agreement with the Company providing that, if a change of control of the Company occurs while he is an employee of the Company, his employment by the Company shall continue for at least three years at an annual rate of compensation equal to his total compensation for the 12 months preceding the change of control. These agreements were entered into in 1976. For purposes of these agreements, a change of control occurs either when more than 30% of the outstanding stock of the Company is acquired by any person, or persons acting in concert, in whole or in part by means of an offer to stockholders of the Company, or when any person, or persons acting in concert, succeeds in electing two or more directors in any one election in opposition to those proposed by the Board of Directors of the Company, or in certain other events.

OTHER BENEFITS

Executive Performance Plan

The Company has a discretionary Executive Performance Plan administered by the Compensation Committee of the Board of Directors which determines from time to time those employees eligible to receive awards under the Plan.

Plan awards, when given, are based upon level of individual performance as well as overall corporate performance and are computed on a percentage of annual salary. The corporate level of performance is measured against an annual profit budget reviewed and approved by the Board of

Directors. Awards can range from 0 to 30% and are paid after the end of the plan year. Awards given attributable to 1980 but paid in 1981 are included, as to the Company's five most highly compensated executives in column 1 of the table titled MANAGEMENT REMUNERATION at page 6 hereof.

Employee Stock Ownership Plan

The Company maintains an employee stock ownership plan designed as a contributory TRASOP qualified under the Internal Revenue Code. The Plan which was established in 1976 for all eligible salaried employees of the Company provides those employees with an opportunity to share in the growth, prosperity and ownership of the Company. An annual contribution to the Plan equal to an investment tax credit of 1% of all expenditures on capital equipment is made by the Company. The contribution is allocated among participants based on salary. Effective January 1, 1980, the Plan was amended to allow employees to make voluntary contributions to the Plan up to an additional 1/2% investment tax credit, to be matched by an additional Company contribution. All Company and employee contributions are invested in Hammermill Common Stock and all dividends are reinvested in such stock. Distribution from the Plan is made upon a participant's retirement, termination or death.

Employee Savings Plan

The Hammermill Thrift Plan is a savings plan for eligible salaried employees. Please refer to "The Hammermill Thrift Plan" at page 11 hereof.

Retirement Plan

Nearly all permanent, full time, regular employees of the Company who are working on a salaried basis are eligible to participate in the Hammermill Salaried Employees' Restated Retirement Plan. The following table shows the estimated annual benefits payable upon retirement under such Plan, exclusive of Social Security benefits, to representative persons in the specified remuneration and years-of-service classifications. These estimated benefits have been calculated in accordance with the Plan's life annuity benefit, which provides retirement benefits for the participant's lifetime. Many optional forms of benefit, such as joint and survivor options, are available for selection by the participant at retirement. The calculation of estimated benefits assumes that the persons in the specified classifications retired effective December 31, 1980, at age 65, having fully participated in the Plan throughout their careers. The actual benefits payable to any participant will depend on his years of service with the Company and his average annual remuneration during his last five of such years. Remuneration includes base salary, commissions and bonuses. The present years of service of Messrs. Duval, Herbolzheimer, Leslie, Stolley and Volanakis under the Plan are 20, 23, 24, 25, and 34, respectively.

Average Annual Remuneration For Last Five Years	Years of Service			
	10	20	30	40
\$ 50,000	\$ 6,323	\$12,646	\$ 18,969	\$ 26,077
100,000	13,823	27,646	41,469	56,077
200,000	28,823	57,646	86,469	116,077
300,000	43,823	87,646	131,469	176,077
400,000	58,823	117,646	176,469	236,077

STOCK OPTIONS

The Company maintains an employees' Qualified Stock Option Plan and an employees' Non-Qualified Stock Option Plan, under which options to purchase Hammernill Common Stock have been and may be granted to key employees of the Company. For information concerning a new option plan called the Hammernill Paper Company 1981 Stock Option Plan please refer to page 12 hereof.

The Qualified Plan was approved by the stockholders May 11, 1965 and was extended by the stockholders to February 6, 1984; however, any option granted or exercised after May 20, 1981 will be treated as a Non-Qualified Option for federal income tax purposes. No options are presently outstanding under this Plan and no further options are intended to be granted.

The Non-Qualified Plan was approved by the stockholders May 9, 1972 and will expire May 9, 1982. At March 24, 1981 there were 50 participants in this Plan with 150,237 shares under option. The number of options granted to participants is determined from time to time by the Compensation Committee of the Board of Directors, acting as a Stock Option Committee. 27,320 Common shares are available for future grants under this Plan.

The following table shows, as to certain Directors and officers, and as to all Directors and officers as a group, the following information with respect to stock options (which contain no tandem rights) granted since January 1, 1976: (i) the aggregate amount of shares subject to options granted during the period, (ii) the average per share option exercise price of options granted during the period, (iii) the net value of shares (market value less any exercise price) or cash realized during the period upon the exercise of options granted during the period or prior thereto, (iv) the number of shares sold during the period by Directors and officers who acquired shares on exercise of stock options during the period, (v) the number of shares subject to all options outstanding as of March 24, 1981, and (vi) the potential (unrealized) value of such outstanding options as of March 24, 1981 (market value less any exercise price).

Common Shares	Albert F. Duval	Fred Herbolzheimer, Jr.	Donald S. Leslie, Jr.	James S. Stolley	Peter G. Volanakis	All Present Directors and officers as a group (18 persons)(1)
Granted since January 1, 1976:						
Number of shares optioned	18,500	8,000	12,000	8,000	10,000	91,500
Average per share option price	\$18.66	\$18.53	\$18.66	\$18.53	\$18.53	\$18.56
Exercised since January 1, 1976:						
Net value realized in shares or cash (2) (4)	\$222,758	\$ 93,530	\$112,445	\$117,810	\$124,840	\$ 957,779
Sales since January 1, 1976: (3)						
Number of shares	14,861	2,241	19,360	4,811	7,668	83,913
Outstanding as of March 24, 1981:						
Number of shares optioned	9,000	8,000	13,750	8,000	6,000	93,787
Potential (unrealized) value—market value less exercise price (4)	\$104,670	\$103,760	\$177,788	\$103,760	\$ 71,460	\$1,202,349

- (1) The information given for all present Directors and officers as a group includes information as to persons within that group only during that portion of the period covered when they were Directors or officers.
- (2) Net value means market price less any exercise price.
- (3) Sales, including shares surrendered in exchange upon exercise of options, since January 1, 1976 by Directors and officers who exercised options during the period covered.
- (4) Determined as though options had been fully exercised on March 24, 1981. Neither the "net value realized" nor the "potential (unrealized) value" takes into consideration the cost of funds used for the purchase price, tax factors, or the fact that officers may not dispose of stock acquired upon exercise for a minimum of six months after purchase at which time the realizable value may be lesser or greater than indicated.

2. APPROVAL OF AN AMENDMENT OF THE HAMMERMILL THRIFT PLAN

The Hammermill Thrift Plan (the Plan) was adopted by the Board of Directors of the Company February 23, 1976 and approved by the stockholders May 11, 1976. The Plan is a personal savings plan for salaried employees of the Company. Approximately 3,200 persons are participants. Its purpose is to encourage employees to provide additional security and income for their future through a systematic savings program and to afford them an opportunity to acquire an equity interest in the Company.

The amendment, as more fully explained hereafter, increases the Company contribution under the Plan. It was adopted by the Board of Directors February 12, 1981 and is submitted herein for ratification by the stockholders at the annual meeting. Upon ratification the amendment will become effective June 1, 1981. Under the Plan, each participant may contribute through payroll deductions up to 12% of the amount by which his monthly salary exceeds \$400. All such contributions by participants are paid to Mellon Bank, N.A., as the Custodian under the Plan, and invested by the Custodian in a Fixed Income Fund which presently consists of investments in contracts issued by insurance companies which provide guaranteed annual rates of return ranging from 9.4% to 13.7%. The Fixed Income Fund does not include any Hammermill Common Stock.

The Amendment. Under the Plan as now established, for each dollar which a participant contributes to the Plan from the first 5% of his monthly salary over \$400, Hammermill contributes \$.50. The amendment changes this formula effective June 1, 1981 so that for each dollar which a participant contributes to the Plan from the first 6% of his monthly salary over \$400, the Company will contribute \$.75.

The Company contribution, above referred to, may be made in cash, in Hammermill Common Stock or in any combination thereof, at Hammermill's option. The Company contributions are held by the Custodian in a Stock Fund, which consists entirely of Hammermill Common Stock except for temporary short-term investments. Participants are not vested in the Company contributions credited to their accounts in the Plan until the end of the third Plan year following the year in which such contributions are made. However, when a participant in the Plan becomes eligible for early retirement under the Hammermill retirement plan maintained for salaried employees at his location (generally at age 55 with 10 years of service) he becomes fully vested with all Company contributions made to his account in the Plan. Through 1980 the Company has contributed approximately \$3,560,000 to the Plan.

The Thrift Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and is qualified under Section 401(a) of the Internal Revenue Code of 1954, as amended.

Copies of the amending resolution, as well as copies of the Plan, as amended, will be available at the annual meeting.

The affirmative vote of the majority of the Common shares and Second Cumulative Preferred shares outstanding at the close of business on March 24, 1981 is required for approval of the aforementioned amendment of the Hammermill Thrift Plan.

The Board of Directors recommends a vote "FOR" the approval of the amendment of the Hammermill Thrift Plan. Proxies solicited by the Board of Directors will be so voted unless shareholders specify otherwise in their proxies.

3. ADOPTION OF THE HAMMERMILL PAPER COMPANY 1981 STOCK OPTION PLAN

The Board of Directors has by resolution of February 12, 1981 adopted a "Hammermill Paper Company 1981 Stock Option Plan" (the Plan) and directed that the same be submitted to stockholders for approval May 12, 1981. At the stockholders' meeting the proposal will be made that the Plan, the full text of which appears in Exhibit A of this Proxy Statement, be approved.

In addition to the grant of stock options the Plan also provides for the discretionary grant of a stock appreciation right (SAR) at the time and at the option price at which a related stock option is granted covering a number of shares not to exceed the number covered by the related stock option.

The purpose of the Plan is to advance the interests of the Company and its stockholders by affording to key employees, upon whose judgment, initiative and efforts the Company is largely dependent for the successful conduct of its business, an opportunity for investment in the Company, and the incentive advantages inherent in stock ownership in the Company. It is believed that the acquisition of such interest in the Company with related stock appreciation rights provides such employees additional incentives to remain in the employment of the Company and to increase their efforts on its behalf.

Eligibility of officers and other employees of the Company to receive non-qualified options and stock appreciation rights under the Plan is determined by a Stock Option Committee appointed by the Board of Directors consisting of not less than three Directors who are not eligible to receive options or stock appreciation rights under the Plan. Grants of options and stock appreciation rights shall be made by the Committee from time to time in its sole discretion. The Committee does not intend to grant any options or stock appreciation rights until the Plan is approved by the stockholders. Approximately 100 key employees of the Company including executive officers may be deemed eligible to participate in the Plan.

The material features of the Plan, together with appropriate comments on such features, are summarized below:

- (1) The purpose of the Plan is to advance the interests of the Company and stockholders by affording to key employees an opportunity for investment in the Company. The total number of Common shares subject to option under the Plan is 400,000.
- (2) The Plan shall be administered by a Stock Option Committee consisting of three Directors not eligible to receive options or stock appreciation rights. The Committee shall have final authority to determine those key employees of the Company eligible to receive options and stock appreciation rights under the Plan.
- (3) Options and stock appreciation rights may be granted only to those executives and key employees who are in the active employment of the Company. Each option and grant of a stock appreciation right shall include an acceptance by the employee to remain in the employment of the Company for not less than two years.
- (4) Each option and each SAR shall, unless exercised, expire ten years after date of grant and shall not be granted at less than the fair market value of Hammermill Common on the New York Stock Exchange on the date upon which the option or SAR is granted.
- (5) An option may be exercised by payment in cash or shares of stock of the Company already owned by the optionee.
- (6) The Stock Option Committee may, in its discretion, grant up to an equivalent number of stock appreciation rights to an employee who is granted a stock option under the Plan at the time and at the option price at which the related stock option is granted. Such stock appreciation right shall be a right to receive a cash payment equal to the excess of the fair market value of the shares (with respect to which the stock appreciation rights are exercised) at the time of such exercise, over the option price for such shares. Stock appreciation rights may only be exercised in conjunction with the exercise of a related option to purchase an equal or greater number of shares of stock under the Plan.
- (7) The Board of Directors shall have the right, from time to time, to suspend or discontinue the Plan or amend it in any manner whatever, without prejudice to options or stock appreciation rights then granted and outstanding; however, the Board cannot, without stockholder approval, increase the number of shares reserved thereunder, nor extend the termination date, nor grant options at less than 100% of fair market value.
- (8) Unless sooner terminated, the Plan will terminate on May 12, 1991, and thereafter no further options or stock appreciation rights may be granted under it.

With respect to both the non-qualified stock options and the stock appreciation rights granted under the Plan, the difference between the option price and the fair market value at the date the option is exercised or stock appreciation rights are surrendered is taxable income to the optionee and is deductible by the Company for federal income tax purposes. The Company will make available to each optionee non-interest bearing loans limited to use in payment of the minimum federal income tax rate plus applicable state and local income taxes. Such loans will be further limited to not exceed \$24,500 and must be fully paid within two years.

If the Plan is approved by the stockholders, the resulting compensation, if any, to the optionees will be accounted for by charges against operating income.

The affirmative vote of the majority of the Common shares and Second Cumulative Preferred shares outstanding at the close of business on March 24, 1981 is required for approval of the 1981 Stock Option Plan. If the Plan is approved by the requisite vote, it will become effective as of February 12, 1981, the date when it was adopted by the Board of Directors.

On March 24, 1981 the last-reported sale price of Hammermill Common Stock on the New York Stock Exchange was \$31 $\frac{3}{4}$.

The Board of Directors recommends a vote "FOR" the approval of the Hammermill Paper Company 1981 Stock Option Plan. Proxies solicited by the Board of Directors will be so voted unless shareholders specify otherwise in their proxies.

SECURITY OWNERSHIP

On March 24, 1981 the Directors and officers of the Company beneficially owned shares of the Company's Common Stock as follows:

Name	Shares beneficially owned (1)	Shares optioned	Percent of class (2)
Roger S. Ahlbrandt	100	—0—	nil
Henry Curtis	1,000	—0—	nil
Albert F. Duval	9,580	9,000	.2
Fred Herbolzheimer, Jr.	12,909	8,000	.2
Bernard S. Kubale	100	—0—	nil
William G. Kuhns	1,000	—0—	nil
Donald S. Leslie, Jr.	18,894	13,750	.4
Louis H. Roddis, Jr.	500	—0—	nil
Charles M. Williams	200	—0—	nil
Directors and Officers as a group (18 persons)	72,057	93,787	2.07

- (1) Includes shares allocated to the accounts of persons named above under the Company's Thrift Plan and Stock Ownership Plan ("TRASOP"). Under the Thrift Plan and under the TRASOP, shares are purchased with Company contributions. These shares are allocated to participants' accounts (subject to forfeiture under certain conditions) and may be voted by the participants. Does not include shares subject to presently exercisable options, which are deemed to be beneficially owned and are shown in the next column.
- (2) The percent of class shown for each individual named or referred to in the table assumes exercise by him of all his options to acquire Common Stock, but assumes no such exercises by the other persons named or referred to in the table. Percentages less than .1% are shown as "nil".

To the best of the Company's knowledge, no person not named or referred to below was the beneficial owner of more than 5% of the Company's Common Stock at March 24, 1981.

The Company has been informed on the basis of Schedule 13D reports filed with the Securities and Exchange Commission that Icahn & Co., Inc., a Delaware corporation, CCI & Associates, a New York limited partnership, and Leba Partners, a New York limited partnership, all having their principal place of business at 25 Broadway, New York, New York 10004, and Bayswater Realty & Investment Trust, an Illinois business trust with principal executive offices at 25 Broadway, New York, New York 10004, are the beneficial owners of shares of Hammermill Common Stock. Icahn & Co., CCI, Leba and Bayswater may be deemed a "group" within the meaning of Regulation 13d-5 promulgated under the Securities Exchange Act of 1934, as amended. The aggregate number of shares beneficially owned by the "group" as of March 24, 1981 was 800,300 shares or 9.99% of the shares then outstanding.

During 1980 Carl C. Icahn and others associated with him acquired approximately 10.88% of the Company's then outstanding common stock and conducted a proxy contest for the election of Mr. Icahn as a director of the Company. The nominees of the Board of Directors were Messrs. Curtis and Duval. In connection with this contest, litigation was instituted by the Icahn group and by the Company concerning, among other things, the validity of certain votes cast for the various nominees. In July of 1980 this litigation was settled by an agreement among the parties, under which all such litigation was terminated, the Icahn group was paid \$750,000 by the Company towards its legal expenses in connection with the contest and the litigation, and the Icahn group agreed not to conduct another proxy contest for the election of directors at the 1981 annual meeting. The independent judge of election certified that in the 1980 election 4,336,474 votes were cast for Mr. Curtis, 4,336,474 for Mr. Duval and 2,165,463 were cumulatively voted or 4,330,926 were cast for Mr. Icahn. 45,921 proxies were marked to withhold authority to vote for any of the nominees. Messrs. Curtis and Duval, therefore, were elected directors of the Company and are presently serving as such.

PRINCIPAL ACCOUNTANT

The Company's principal accountant for the current year, as selected by the Board of Directors, is Price Waterhouse & Co.

Price Waterhouse & Co. has served as the Company's auditors for many years, although the Price Waterhouse personnel who work on the audit change at regular intervals in accordance with Price Waterhouse policy. Representatives of Price Waterhouse are expected to be present at the meeting with the opportunity to make a statement if they desire to do so and are expected to be available to respond to appropriate questions.

In connection with its examination of the Company's 1980 financial statements, Price Waterhouse also reviewed the Company's Annual Report and its quarterly and annual financial statements filed with the Securities and Exchange Commission. In addition to audit services Price Waterhouse also rendered certain professional services for which its fees were 25% of audit fees. Such non-audit functions included professional advisory services regarding tax matters and rendering of technical assistance in the conversion of a major computer installation. The fees for these services were 5% and 20% of the audit fee, respectively.

These non-audit services in 1980 were approved by the Audit Committee, which has approved the rendering of similar services by Price Waterhouse in 1981. The Audit Committee believes that such non-audit services did not and will not affect the independence of Price Waterhouse & Co.

OTHER MATTERS

At this time, the Board of Directors knows of no matters to come before the meeting except as set forth above. If any other matter properly comes before the meeting, however, it is the intention of the persons named in the enclosed form of proxy to vote said proxy in accordance with their best judgment.

Proposals for 1982 Annual Meeting

Shareholder proposals for the 1982 annual meeting must be received at the principal executive offices of the Company, 1540 East Lake Road, Erie, Pennsylvania 16533, addressed to the attention of the Secretary, no later than January 11, 1982 for inclusion in the 1982 proxy statement and form of proxy.

By the Order of the Board of Directors
R. J. Kilgore, *Secretary*

Erie, Pennsylvania
April 6, 1981

EXHIBIT A

HAMMERMILL PAPER COMPANY 1981 STOCK OPTION PLAN

I. Purpose

The purpose of the Plan is to advance the interests of Hammermill Paper Company (the "Company") and its stockholders by affording to key employees of the Company and its subsidiaries, upon whose judgment, initiative and efforts the Company is largely dependent for the successful conduct of its business, an opportunity for investment in the Company, and the incentive advantages inherent in stock ownership in the Company. It is intended that this purpose will be effected through the granting of stock options with or without related stock appreciation rights as provided herein.

II. Adoption, Approval and Duration of the Plan

This Plan was adopted by resolution of the Board of Directors February 12, 1981, and is to be voted upon by the stockholders May 12, 1981.

The Plan shall terminate May 12, 1991, unless discontinued earlier as provided in Section VIII hereof. No options or stock appreciation rights shall be granted under the Plan after its termination or discontinuance, but neither such event shall impair the validity of options or stock appreciation rights then outstanding.

III. Stock Subject to the Plan

The shares covered by this Plan shall be shares of Common stock of the Company (\$1.25 par value) which are authorized and unissued, or shall have been issued and reacquired and are held in the Treasury of the Company. The total number of shares subject to option throughout the duration of the Plan shall be 400,000. Any shares subject to an option granted hereunder which remain unexercised upon termination or expiration may be used for additional options under the Plan. An option may be terminated before exercise by mutual agreement of the Company and the optionee.

IV. Administration of the Plan

The Plan shall be administered by a Stock Option Committee (herein referred to as the Committee) appointed by the Board of Directors and consisting of not less than three (3) Directors who are not eligible to receive options and stock appreciation rights under the Plan.

The Committee shall have full and final authority to determine from time to time those key employees of the Company and its subsidiaries, eligible to receive options and stock appreciation rights under the Plan, to whom options and related stock appreciation rights are to be granted, whether and the extent to which any optionee shall be granted stock appreciation rights in accordance with Section VII hereof, the number of shares to be included in each option and stock appreciation right, the option price and the term and form of the option and its related stock appreciation right.

The Committee may interpret the Plan, may promulgate, amend and rescind rules and regulations which it deems necessary or appropriate for administration of the Plan, and take any action which it deems to be necessary or proper to administer the Plan. Any action of the Committee within its prescribed authority shall be final and binding on all parties.

V. Eligibility of Optionees

Options and stock appreciation rights may be granted only to those executives and key employees who are in the active employ of the Company or any subsidiary thereof (said employees being herein referred to as employed by the Company). Determination as to which employees are eligible under these standards shall be made by the Committee from time to time in its sole discretion. An individual who has been granted an option and stock appreciation rights may be granted additional stock appreciation rights and options if he is otherwise eligible.

VI. Stock Options

Each stock option granted under the Plan shall be in writing, and in such form as is prescribed by the Committee and shall comply with the following terms and conditions and any other terms and conditions which the Committee shall deem to be appropriate.

(a) Acceptance and Employment Agreement

Each option shall include an acceptance thereof by the employee and agreement by the employee to remain in the employ of the Company for not less than two (2) years from the date of acceptance, without prejudice to the right of the Company to terminate the employment of the employee at any time, with or without cause.

(b) Option Period

Each option shall state the date upon which it is granted, and shall expire ten (10) years after said date. Each option by its terms shall not be exercisable within 6 months from the date of grant, shall terminate 3 months after an option holder retires and immediately when an optionee ceases to be an employee of the Company for any reason other than by

retirement or death. In the event of death of an employee or the death of a retiree within 3 months of his retirement date, his option shall be exercisable as provided in Paragraph (f) below.

(c) Option Price

Each option shall state the option price, which shall not be less than the fair market value on the date upon which the option is granted. Fair market value shall be the average between the high and low sales on the New York Stock Exchange on said date, or in the event there are no sales on said date, the average between the high and low on the last preceding day upon which there were sales.

(d) Method and Time of Payment

Any exercise of an option must be in writing signed by the optionee and received by the Company at its principal office in Erie, Pennsylvania accompanied by:

1. cash or a check in full payment for the number of shares in respect of which the option is exercised, or
2. by shares of outstanding Common stock of the Company with the same voting rights, dividend rights and other features as the shares subject to option. In the event payment is made in whole or in part by shares of stock of the Company already owned by the optionee, said shares shall be deemed to have a per share value equal to the per share fair market value of the option shares then being issued; such fair market value to be the average between the high and low sales on the New York Stock Exchange on said date, or in the event there are no sales on said date, the average between the high and low on the last preceding day upon which there were sales.

(e) Options Not Transferable

Each option by its terms shall not be transferable or assignable otherwise than by will or by the laws of descent and distribution, and during the lifetime of the optionee shall be exercisable only by him.

(f) Exercise in Event of Death

If an optionee shall die while an employee or within 3 months of his retirement date and prior to the expiration date of his option, the option may be exercised to the extent of any shares as to which it remains unexercised, by the estate of the deceased optionee or by the person who has acquired the option by will, inheritance or distribution, provided such

exercise shall be prior to the stated expiration date of the option. If any option shall include a waiting period before exercise, this period shall be deemed to have ended at the time of death.

(g) Changes in Common Shares

The number of shares of Common stock covered by each option granted and outstanding under the Plan, and the price per share, shall be adjusted by the Committee to reflect any stock dividend, stock split, share combination or exchange, recapitalization, merger, consolidation or reorganization, in such manner as the Committee shall deem appropriate.

The Committee shall also have the power and authority to adjust appropriately the number of aggregate shares covered by the Plan, upon occurrence of any of the aforesaid events.

(h) Tax Withholding

The Option Agreement shall include as a condition of acceptance that the employee will (i) authorize the Company to withhold from wages appropriate income taxes or (ii) agree to pay appropriate income taxes in a manner satisfactory to the Company.

(i) Other Provisions

The Option Agreement authorized by the Plan shall include such additional provisions not inconsistent with this Plan and its purpose, as the Committee deems to be advisable.

VII. Stock Appreciation Rights

The Committee may, in its discretion, grant up to an equivalent number of stock appreciation rights to an employee who is granted a stock option under the Plan at the time and the option price at which the related stock option is granted. A stock appreciation right shall be a right held by an optionee to elect to receive a sum in cash equal to the excess of the fair market value of the number of shares with respect to which the stock appreciation rights are exercised at the time of such exercise over the option price for such number of shares. A stock appreciation right may be exercised only in conjunction with the simultaneous exercise of a related option to purchase an equal or greater number of shares of stock under this Plan. In the event of the expiration or termination of an unexercised stock option, any related stock appreciation right which has not been exercised shall likewise expire or terminate. Stock appreciation rights shall be granted and accepted under the Plan in writing and shall be entitled to, be governed by and comply with all of the terms and conditions prescribed for stock options at Section VI hereunder, except that no payment shall be required to exercise a stock appreciation right, and no stock appreciation right

shall be exercisable by an optionee who is a director or officer of the Company, as the terms "director" and "officer" are used in Section 16(b) of the Securities Exchange Act of 1934, except in a transaction which meets all of the conditions of Rule 16b-3(e) of the Rules and Regulations under such Act or any applicable future law, rule or regulation corresponding thereto.

VIII. Discontinuance and Amendment

The Board of Directors shall have the right, from time to time, to suspend or discontinue the Plan or amend it in any manner whatever, without prejudice to options or stock appreciation rights then granted and outstanding.