“3rd Annual Executive Compensation Conference”

Course Materials

Note these course materials—among others—are also available online, as well as a video archive of the entire conference.

October 12, 2006

CompensationStandards.com

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Talking Points - What You Should Be Telling Your Board and Compensation Committee Now

(10/12/06)

Fred Cook, Frederic W. Cook & Co and John Olson, Gibson Dunn & Crutcher LLP

Current State of Affairs

- Executive Compensation is in the spotlight as never before:
  - Impact of new SEC rules
  - Importance of restraint and transparency
- Compensation Committees have new challenges but full Board needs to also be engaged.

Ten Important Issues for Boards and Compensation Committees to Consider

1. Is the executive program **supported/respected internally?**
2. Are **surveys used fairly** to monitor pay competitiveness?
3. Are **internal equity** considerations given equal weight to external competitiveness?
4. Is fairness to executives balanced with **fairness to the company and shareholders?**
5. Is the program **administered consistently** and not opportunistically?
6. Does the Committee monitor top executives' **total compensation?** Is total direct compensation reasonable given the Company's **relative size and performance**?
7. Does the Committee **know what is owed** to executive officers under various termination of employment and CIC scenarios?
8. Does the Committee know the **total compensation implications** of changing one element of pay?
9. Is the Committee receiving **objective advice?** Are the **pros and cons and potential risks**, of new proposals presented fairly?
10. Does the program meet evolving **best practices** and **new standards** for executive compensation design and board governance?

Hot Button Issues in Executive Compensation

- Perks – planes trains and automobiles
- Retirement benefits; SERPS
- Change of Control and Severance
- Why have a contract at all?
- Zero based thinking: don't just repeat every year. Is added incentive really needed?

Board and Compensation Committee Concerns

- Avoiding criticism/enhancing reputation
- High standards of care and due diligence
- Obtaining objective input
- Linking incentives to corporate strategy
- Assessing total compensation
- Avoiding surprises
- Shaping the debate on CEO pay for performance

What Committees Should be Asking From Their Advisors?

- Independence; duty of loyalty
- Due diligence; duty of care
- Proactive advice on best practices
- Identification of potential pitfalls and red flags
- Independent recommendations on CEO pay and benefits
- Ways to improve total compensation transparency and executive compensation governance
- Objective advice but also value-based points of view

What Lawyers and Consultants Should Now be Doing

- Be more than scribes for management; duty is to corporation (through Board)
- Present the full disclosure approach to boards, rather than the minimal required disclosure approach (and real potential liability e.g., Tyson and future SEC enforcement actions)

- The obligation of counsel to bring to their boards important guidance that directors need to see first hand (not distilled into a short summary or screened out entirely)
- Don't just hold your nose – do something

Talking Points: What Now Needs to be Disclosed in the Proxy Statement (10/12/06)

Mark Borges of Mercer Human Resources Consulting and Ron Mueller of Gibson Dunn & Crutcher LLP

I. The new Compensation Discussion and Analysis

A. The CD&A will have to provide far more information and analysis than has been included in the Board Compensation Committee Report

B. The scope of the CD&A
1. The relationship to MD&A – companies must provide an analysis of the numbers that appear in the compensation tables, giving shareholders a window into the compensation committee's thinking when they made decisions regarding the forms and amounts of compensation paid to the CEO and other NEOs
2. The critical task – identifying and explaining the rationale for your compensation decisions – how compensation was actually determined

C. How the CD&A differs from both the old and the new Compensation Committee Report
1. Explain all material elements of NEO compensation, with a focus on the material principles underlying the company's compensation policies and decisions, and the most important factors relevant to the analysis of these policies and decisions
2. Requires analysis – this is the main difference from the BCCR, not just an explanation of the goals of the company's compensation arrangements, not just a discussion of policies and not just a discussion of the individual elements, but an analysis of why this approach was taken and how the elements operate, how they all fit together, how they further the company's goals

D. Discussing your compensation program
1. The CD&A is to be tailored, specific analysis of actual compensation amounts paid to a company's CEO and other NEOs and the compensation committee's reasons for structuring and sizing each element of pay in relation to the whole
2. Because the discussion will be based on each individual company's own circumstances, each company will have to decide for itself the material elements of its compensation and decision- making process to be discussed
3. The discussion will need to cover all elements of the program, including perquisites and retirement, severance, and change in control arrangements
4. The discussion of performance-based compensation will need to cover specific items of corporate performance and how specific forms of compensation are structured and implemented to reflect these items of individual and corporate performance
5. The discussion will also need to address equity award grant practices, particularly stock option grant timing issues

E. Addressing the compensation process
1. Companies should consider describing the processes the compensation committee followed and the information that it considered in arriving at its decisions
2. This discussion will need to be coordinated with corporate governance disclosure

F. Preparing the CD&A
1. Remember to use "plain English" – report should minimize the use of defined terms, explain certain commonly-used terms (for example, long-term incentives), and use concrete, everyday words
2. Biggest help will be the use of descriptive headings and subheadings – since CD&A must address several topics

3. Appropriate question is: what are we trying to accomplish with our executive compensation program; what are the objectives for which we are compensating our CEO and the other NEOs? What are the decisions that the compensation committee made, and how do they relate to these objectives?
4. Remember – the CD&A is supposed to represent the viewpoint of the compensation committee

II. The New Disclosure Tables

A. The Summary Compensation Table – What has changed?
   1. The new Total Compensation column
   2. The new Stock/Option Awards columns
      a. What constitutes a stock award?
         i. Awards that derive their value from equity securities
         ii. Awards that permit settlement by issuance of securities
         iii. Other awards within the scope of SFAS 123(R)
         iv. The column will include both service-based and performance-based awards
      b. What constitutes an option award?
      c. Calculating an award's reportable value – grant date fair value for financial reporting purposes
      d. The treatment of earnings on outstanding awards -- dividends and dividend equivalents must be reported "when those amounts were not factored into the grant date fair value required to be reported for the stock or option award."
   3. The new Non-Equity Incentive Plan Compensation column
      a. The definition of an "incentive plan award" – any plan providing compensation intended to serve as incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance of the company or an affiliate, the company's stock price, or any other performance measure
         i. A "non-equity incentive plan award" is determined by reference to an equity incentive plan: An "equity incentive plan" is an incentive plan or portion of an incentive plan under which awards are granted that fall within the scope of SFAS 123(R). A "non- equity incentive plan" is an incentive plan or portion of an incentive plan that is not an equity incentive plan
      b. The relationship to the Bonus column
      c. These awards must also be reflected in the Grants of Plan- Based Awards Table
      d. Unlike stock and option awards, earnings on outstanding non-equity incentive plan awards are included in this column
   4. The new Change in Pension Value and Nonqualified Deferred Compensation Earnings column
      a. Relationship to Pension Plan Table
         i. Present value of accrued benefit at year-end measurement date minus present value of accrued benefit at prior year-end measurement date
         ii. Increase in value includes the value of benefit earned in current fiscal year, the growth in value of benefits earned in prior fiscal years due to the passage of time, the impact of changes in assumptions, and, for employees who terminate during the year, the impact of actual benefit payment versus prior year's assumptions
      b. Above-market earnings on nonqualified defined contribution plans
         i. Use of actual investment returns or indices should not result in above-market returns to be reported
         ii. Above-market earnings equal excess of actual earnings over 120% of the Applicable Federal Rate
   5. The All Other Compensation column – includes all other compensation items
      a. Perquisites
      b. Tax "gross-ups" and other tax reimbursements
      c. Discount stock purchases
      d. Amounts paid or accrued. . . in connection with any termination
         i. May be broader than just severance
      e. Company contributions to defined contribution plans (both tax-qualified and non-tax-qualified)
      f. Life insurance premiums
      g. Reportable earnings on stock awards and option awards

B. Grants of Plan-Based Awards Table
   1. Important to understand definitions
   2. Covers each grant of an award made to an NEO in the last completed fiscal year under any plan (including awards that subsequently have been transferred)
   3. Each grant is disclosed individually on a separate line. If grants of ` awards were under more than one

plan, identify the particular plan under which each such grant was made

C. Outstanding Equity Awards at Fiscal Year-End Table
    1. Covers unexercised options, stock that has not vested, and equity incentive plan awards for each NEO outstanding as of the end of the last completed fiscal year
        a. Options are disclosed on an award-by-award basis, while stock awards can be disclosed in the aggregate

D. Option Exercises and Stock Vested Table
    1. Covers exercise of stock options, SARs, and similar instruments, and each vesting of stock (including restricted stock, RSUs, and similar instruments) during the last completed fiscal year
        a. Disclosure can be made on an aggregated basis

III. The New Post-Employment Disclosures

A. The new Pension Plan Table
    1. Coverage – both qualified and non-qualified plans
        a. The basic calculation – the actuarial present value of the accumulated benefit
            i. What is it?
            ii. How it differs from ABO and PBO?
            iii. Relationship to SCT pension disclosure
    2. Disclosure challenges – determining the appropriate assumptions to be used
        a. Retirement age – must use normal retirement age or, if not defined, earliest age eligible for unreduced benefits (NOTE: employment contracts might not define normal retirement age)
        b. Payment form – use same assumption as for FAS 87
        c. Lump sum/annuity conversion rates – use same assumption as for FAS 87
        d. Discount rate – use same assumption as for FAS 87
        e. Increases in covered compensation, OASDI wage base – do not use
        f. Reflect subsidies to which NEO is currently eligible (for example, an unreduced joint and survivor benefit that is only available at early retirement would not be reflected unless NEO is eligible for early retirement)
        g. Treatment of other demographic assumptions (turnover, disability, mortality)
    3. The supplemental narrative disclosure

B. The new Nonqualified Deferred Compensation Table
    1. Coverage – non-qualified plans only
    2. Disclosure challenges
        a. Disclosing earnings – including situations where contributions are invested in actual or notional investment funds
    3. The supplemental narrative disclosure
        a. Deferrable compensation
        b. Earnings calculation
        c. Payment terms
    4. Overlap with Summary Compensation Table
        a. Named executive officer contributions will also show up in Salary and Bonus columns of SCT
        b. Company contributions will also show up in All Other Compensation column of SCT
        c. All earnings will be reflected in table; above-market or preferential portions will show up in Change in Pension value and Nonqualified Deferred Compensation Earnings column of SCT

C. The new termination of employment and change-in-control disclosure
    1. As a practical matter, will involve tabular disclosure quantifying post-termination payments and benefits (including perquisites and health care benefits)
    2. Covers any arrangement providing for payments in connection with any termination of employment, including:
        a. Resignation
        b. Retirement
        c. Termination with or without cause (including a constructive termination)
        d. Change in control
    3. Covers any payments and other benefits (including perquisites and health care benefits) payable upon the occurrence of any of these events
    4. Estimate to assume event occurred on last business day of last completed fiscal year and at stock price on that date

5. If uncertain, provide reasonable estimated range of possible payouts

Talking Points: “The Consultants Speak”

Doug Friske

Managing Principal

October 11, 2006

Concerns with Executive Pay – 2005 CS Conference

- Excessive reliance on market data
- Lack of disciplined and consistent administration of pay plans
- Difficulty saying no
- Poor succession planning
- Excessive focus on best practice, as opposed to best fit
- Missing big picture (i.e., total rewards)

We're Starting to See Some Change

- Broadened definitions of market, use of internal pay comparisons
- Greater customization of rewards to fit unique Company circumstances
- Less willing to make exceptions (which usually only favor management)
- Near universal use of tally sheets and related tools
- Sharper focus on employment agreements and severance provisions

However, Still Room for Improvement

- Succession planning
- Reliance on market data as required pay
- Consistent application of pay for performance
- Rationalizing total pay levels

Action Items – 2005 CS Conference

- View market data as an input, not a decision
- Ensure Compensation Committees have complete understanding of all relevant factors
- Allow thoughtful discussion and apply judgment
- Build stronger performance management system, including succession planning

One year later these all still makes sense

Additional Action Items

- Rationalize each element of the existing program against business priorities
  - Feeds into preparation of the CD&A report
  - Avoid boilerplate or use of generic mock-ups
- Pay special attention to special severance, perquisites and retirement benefits
  - Examine anything that is unique to executives
- Understand the future implications of existing pay arrangements
- Don’t underestimate the internal implications of the new disclosure requirements
- Ensure strong relationships with your investor base

Talking Points: Back to Basic Pay-for-Performance (10/12/06)

George Paulin is Chairman & CEO of Frederic W. Cook & Co., Inc.

Problem With Executive Compensation

At many US public companies, pay for performance is little more than words in a pay philosophy statement. The focus of executive compensation program design has become pay delivery and employment retention, not rewarding results.

Evidence of the Problem

Executives generally have an entitlement attitude toward earning incentive compensation that is supposed to be at risk, and this is too difficult for most board compensation committees to confront. The problem is evident in several ways.

One example is goal setting for annual cash bonuses, which typically pay at or above competitive "target" amounts unless something goes seriously wrong. Another example is the structure of long-term incentives. During the 1990s when the stock market was rising, awards were predominately in the form of options. Now, in a less certain stock market, the single most dramatic trend in executive compensation is replacing options with risk-free, time-based restricted stock.

A further example is the substantial "fringe" compensation that has no intended relationship to performance, often is ignored in determining total compensation value, and until next year has gone largely undisclosed. Here, I am referring to perks like personal use of corporate aircraft at shareholders' expense, defined-benefit supplemental executive retirement plans ("SERPs"), above-market interest on deferrals, and severance benefits that potentially reward failure.

Proposed Solutions

There is no easy solution, but six basic and simple steps would go a long way:

1. **Design incentives with real performance risk and leverage, and look for this relationship in the new proxy disclosures.** Annual cash bonuses should relate to annual operating results. Changes in unvested, unexercised, and deferred equity values should relate to total shareholder return. Goals for earning annual bonuses should reflect absolute results and peer comparisons, rather than just internal budgets that are notoriously sandbagged. Heavy reliance on time-based restricted stock at the executive level should be avoided. If a company has a low-risk structure designed to deliver compensation regardless of performance, then it should pay low relative to peers and vice versa.

2. **Hold CEOs accountable.** I have yet to see a company with excessive CEO compensation where the CEO did not want it, ask for it, and refuse to give it back. Institutional investors are misguided in withholding votes only from directors on the compensation committees in these instances. They should withhold votes from the CEOs too.

3. **Demand that board compensation committees have INFORMED independence.** All important committee decisions involving judgment should pass a two-pronged test. First, the judgment should be reasonable relative to market practice, which admittedly varies so widely that there is little guidance and the second test becomes critical. The second test is that the judgment should be appropriate in terms of a business rationale. For example, if a company wants to be the highest payer in its peer group, then it should have the highest performance as evidence that high pay is being used to attract and retain the best talent. (As an aside, the most important work that I do as an advisor to compensation committees is making sure that their judgment is tested in these two ways.)

4. **Grow your own.** The single biggest factors contributing to executive compensation inflation are outside recruiting,

and negotiating with someone who you cannot afford to lose because there is no replacement. Succession planning is a critical part of executive compensation and should be a higher priority on board compensation committee agendas.

5. **Total-up all of the pieces.** A defined-benefit SERP is another form of long-term capital accumulation, no different than restricted stock except in cash. If you have such a plan, then the value should be offset from ongoing long-term grant values. The same is true for above-market interest on deferrals. It has compensation value and cost, which should be taken into account in setting other pay elements. Under the new proxy disclosure rules, we should have the total pay numbers that we need to support this direction.

6. **Take CEO compensation out of management's hands.** Compensation committees should make decisions on pay increases, bonuses, and equity grants for the CEO based on analyses and recommendations by their own advisors, recognizing that internal staff are potentially conflicted.

For more information, contact info@compensationstandards.com or call 925.685.5111.

"The Consultants Speak" on What You Need to Do Now (10/12/06)

Michael Kesner, Deloitte Consulting

Restore Integrity	Improve the Process	Avoid Liability
• Eliminate perks	• Designate an executive compensation "expert" on the Compensation Committee	• Implement proper controls and processes over compensation administration (including written documentation and training)
• Strip equity gains out of the final average earnings calculation used in determining pension benefits	• Utilize independent advisors	• Have internal audit conduct in-depth reviews of such controls and processes every year and have them report their findings to both the Audit and Compensation Committees
• Other than base salary and benefits, ensure that all of the senior executives' remaining pay is performance-based	• Encourage all non-employee directors to participate or provide feedback in the compensation decision process	• Make sure no one person is responsible for all aspects of executive compensation
• Tighten up stock ownership requirements; review what counts towards ownership and consider adding retention requirements that extend beyond attainment of the ownership standard (e.g., to "hold until retirement" provisions)	• Have the full Board approve CEO pay, not just the Compensation Committee	• Carefully document compensation decisions in meeting minutes, resolutions, written reports and analyses

Restore Integrity	Improve the Process	Avoid Liability
• Alter severance agreements to eliminate the “pro-executive” provisions, and replace them with a more balanced approach (e.g., use target not maximum bonus, scale back to safe harbor, and eliminate the excise tax grossup or use “modified” grossup language)	• Conduct written evaluations of the CEO and other top executives’ performance	• Be sure all statements in the CD&A can be fully supported with source documents, analyses, minutes, etc. (See Attachment)
• Eliminate above market interest crediting rates on deferred compensation	• Use multiple data sources to evaluate pay levels	• Ensure the corporate secretary and where appropriate, legal counsel are involved in the compensation decision cycle
• Establish wealth accumulation targets; evaluate what actions, if any, are needed once the target levels are attained (e.g., cap pension accruals, stop awarding additional equity and/or reduce severance benefits)	• Conduct a dry run of the CD&A and proxy now; take corrective action where appropriate	
• Provide shareholders with a clear explanation of how pay relates to performance in the CD&A	• Conduct a “clean slate” review of the existing compensation program. Be able to justify/articulate each element of pay, the level of compensation and the performance standards being used	
	• Fully review tally sheets and address large or unusual payments upon termination	

Restore Integrity	Improve the Process	Avoid Liability
	• Provide Committee members with a summary of the executive compensation program, including the reasons for each element, the performance metrics and benchmark methodology	
	• Prepare sensitivity analyses of payouts before approving a new incentive plan	
	• Solicit input from investors on the performance metrics and pay practices they value most	

Topic	**Required Documentation**
1. Compensation Philosophy	• Written compensation philosophy • Meeting materials and minutes evidencing: – Summary of discussion(s) – Compensation philosophy of competitors – Analysis of how the Company's program fits the philosophy. For example, is the Company's 75th percentile pay philosophy supported by 75th percentile performance? – Best practices information (e.g., NACD Blue Ribbon Commission) • Copies of reports prepared by outside advisors.
2. Peer Group and Survey Sources	• Peer data reviewed by the Committee to assess the appropriateness of the proposed peer group. Data should include revenue, market capitalization, net income, total shareholder return, etc. • Survey sources used, and an understanding of the benchmarking methodology (for example, what revenue size was used, was the data regressed, which companies participated in the survey, is the survey the same as last year, are multiple surveys used, are both industry and general industry data being used, how many position matches are there?) • Copies of consultants' reports recommending or approving a peer group. • Analysis, where appropriate, of including or excluding companies from the peer group's competitive pay benchmarks (for example, if two substantially larger companies were excluded from the analysis, would it have a material impact on the median?) • List of surveys considered, but not included in the analysis, and the reasons for their exclusion.

Topic	Required Documentation
3. Pay Mix	• Peer group and survey analysis of competitive pay mix. • Meeting materials evidencing a discussion of the desired pay mix. Is the Company largely following competitive practice, or does it have a specific objective (e.g., "50% cash and 50% equity" or "30% fixed and 70% variable"?) • Documentation for the key objectives of each pay element (base salary, annual incentive, long-term incentive, benefits and perquisites) and how they all fit together. • Documented rationale for each long-term incentive vehicle being used (e.g., why is the Company granting stock options and time vested restricted stock?)
4. Performance measures; incentive plan design	• Rationale for the measures selected. • Analysis that tests the sensitivity of payouts under various performance scenarios. • Evaluation of budgeted performance for degree of difficulty built into the target(s). Such an evaluation should include the Company and peer group's projected earnings growth as estimated by analysts. Thus, if bonus targets for upcoming year reflect 10% increase, how does this increase compare to the consensus earnings estimate for the Company and its peer group. • Historical trends should also be reviewed to evaluate how current your targets compare to past performance. • Comparison of actual to budgeted results the last 3-5 years should also be used (does the Company typically achieve its financial targets, or has actual performance been far short or far in excess of bonus targets? • If individual goals are part of the performance measures, an understanding of the specific goals used for the corporate officers, and how such goals are to be evaluated. • Document discussion of need for clawbacks and what happens if financial results are restated after bonuses have been paid. • Review of pay and performance compared to peers.

Topic	Required Documentation
5. Pay increases	• Peer group and survey comparisons. • Performance considerations used (corporate and/or individual) in determining the increase in pay. How do/should these increases compare to financial or stock price performance? • Market positioning of individual before the adjustment (is individual already at or above median?) • Other factors used to increase (or decrease) pay (e.g., matched a competitive offer).
6. Timing of equity awards (and stock price/number of units)	• Documentation of discussions regarding the timing of equity grants. • If committee has delegated authority to CEO, grant guidelines or limitations on such authority. • Recommend an internal audit review and report that tests to see if the guidelines were followed. • Minutes supporting grants to individual officers and employees, including the stock price to be used and the basis for the price selected.
7. Impact of past compensation on current awards or compensation decisions	• Document discussion of how past or realized compensation should impact current pay decisions (if at all). • Wealth accumulation modeling to determine projected value of existing equity and retirement programs at varying performance levels (without additional awards). It would be important to document how, if at all, such projections impact future pay decisions.

Topic	Required Documentation
8. Termination payments, employment agreements and severance policies	• Documentation of competitive practice. • Discussion of the purpose of such policies and the benefits to the Company and its shareholders (e.g., retention during periods of uncertainty, implementation of restrictive covenants, replacement of existing benefit for a newly recruited executive). • Analysis of cost prior to approval of arrangement(s) and periodic updates. • Evidence that the agreements were thoroughly reviewed by the Committee and its advisors for appropriateness and consistency with intended objectives.[1]
9. Stock Ownership	• Documentation of competitive practice. • Company policy spelling out ownership guidelines, shares included in the analysis, timeframe to achieve compliance and how the shares are valued. • Analysis of compliance with policy and for those executives who do not comply, or are unlikely to attain guideline ownership within specified period, documentation of a "get well" plan agreed to by the executive and approved by committee (or management). • Summary of objectives the policy is intended to satisfy.
10. Accounting and Tax Treatment	• Document estimated impact on P&L of proposed annual incentive and long-term incentive awards (e.g., EPS impact of $.04 per share). • Document due diligence on accounting for long-term awards (for example, was the plan reviewed to make sure it received grant date accounting? Were the retirement provisions discussed?) • Document discussion of Section 162(m) considerations. Did Committee discuss the difficulty of designing an arrangement that met the Company's needs and complied with Section 162(m)? Did the Committee understand the magnitude of the lost tax deduction? Did the Company consider other alternatives to preserve the deduction (like deferral of payouts) and why were those alternatives rejected? • Annual calculation of lost tax benefit due to the application of Section 162(m).

[1] For each example, an overly broad good reason provision could completely undermine the intent of the plan. Thus, the Committee must exercise proper care to ensure the agreements are properly drafted.

2006 NASPP
Third Annual Executive Compensation Conference: Meeting the New Standards

"The Consultants Speak" on What You Need to Do Now

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STEVEN HALL & PARTNERS
EXECUTIVE COMPENSATION

The Consultants Speak

- Executive Compensation Train off of its Tracks
  - Need to overcome years of accumulated neglect due to compliant Committees, greedy executives, cowed HR heads, misuse of peer groups/surveys and piecemeal administration
  - Back to the future
    - Start at ground zero and reassess
- Revolution rather than customary evolution due to impact of
  - New SEC disclosure rules
  - 409A rules on deferred compensation
  - FAS 123R expensing changes for options and other equity grants
  - Anti-dilution pressure on size of share allocations and equity grant rates
  - Option dating abuses
  - Potential for further adverse legislation/regulation

What to Do Now

- Communicate with Compensation Committee and Board
  - Hostility of media, activists, regulators, legislators, investors and voting advisory services
    - Distrust of management
    - Disillusionment with Board governance
  - Glare of daylight on new proxy disclosure
    - Importance of demonstrating considered process
    - Review decisions in context of draft CD&A, Committee report and tables
    - Explore points of vulnerability and why
    - Avoid boilerplate and excuses
    - Use tally sheets and wealth tables under various scenarios in analysis and communication

What to Do Now *(cont'd)*

- Apply New Standard of Reasonableness
  - Focus on total remuneration
  - Marketplace positioning justified only by relative competitive performance
    - Integrity and consistency of peer groups
  - Internal relationships justified only by relative responsibilities and individual contribution
  - Tougher earnout for same level of pay (pay for "results")
    - Re-examine performance criteria and metrics vs. business strategy and creation of both corporate and shareholder value
  - Cutback in share allocations and equity grant rates
  - Lesser opportunity for wealth accumulation/leverage in shift from options to performance-based stock grants
  - Pullback from service vesting restricted stock, SERPs, special benefits and perquisites
  - Crackdown on contracts, CIC payouts, special arrangements; use of tighter definitions

Steven Hall & Partners
Executive Compensation

How to Devise and Utilize the Appropriate Tally Sheets (10/12/06)

Michael S. Kesner, Deloitte Consulting

1. **Tally Sheets and the New Proxy Rules**
    1. The new proxy rules require disclosure of "Total Compensation" in the Summary Compensation Table and "Other Potential Post Employment Payments" in a narrative discussion.
        1. The Company should modify its tally sheets to support the SEC disclosure requirements.
        2. The Compensation Committee should be provided with updated tally sheets when approving changes in the executives' compensation.
    2. The new disclosure rules also require disclosure of the present value of pension benefits and non-qualified deferred compensation balances at yearend.
        1. We believe the tally sheet termination scenarios should also include a "total amount owed the executive as he or she walks out the door" (see Attachment).
        2. Thus, in addition to the payment of severance, acceleration of equity and continuation of benefits, this summary should include the value of vested equity, retirement benefits and deferred compensation owed an executive upon termination.
            1. In addition to summarizing the Company's total obligation to the executive, this analysis will also serve to raise questions about the need for certain programs and policies.
            2. For example, if an executive has $15 million in vested equity incentives, $6 million in pension and another $5 million in deferred compensation, what further post-employment arrangements or obligations should the Company have with the executive?
    3. The SEC has also requested that companies disclose the extent to which past compensation amounts are considered in setting other elements of compensation.
        1. This suggests that a tally sheet capturing prior gains from incentive plans will be necessary to allow the Committee to fully consider the impact of past compensation on current pay decisions.

    2. We also believe that projecting values on outstanding awards is also appropriate to help the Committee (and management) understand the level of incentives already "baked into" existing incentives.

2. **Are the Tally Sheet Amounts Reasonable?**
    1. One of the most common questions from Compensation Committee members and executives alike is "are these amounts reasonable?"
        1. For example, one of our clients was worried that a $50 million change-in-control tally for the CEO might be viewed as unreasonable, and asked me what was "typical."
        2. The $50 million included $12 million in severance (based on a 3x salary and target bonus multiple); $5 million in accelerated time vested restricted stock and stock options; $2 million in enhanced pension benefits; $15 million in vested stock options; and $10 million in vested pension and deferred compensation. In addition, the excise tax grossup for Section 280G purposes was estimated to be $7 million.
        3. None of the specific CIC provisions (e.g., 3x severance multiple, excise tax grossup, accelerated equity vesting) was out of line with competitive practice, the executive was a long service employee (thus, the pension was built up over a full career) and the Company performed quite well, hence the considerable equity value.
        4. What "stuck in the Committee members' craw" was the fact that the CEO had $25 million in equity and pension benefits, and he had previously cashed-in another $25 million in option gains over the last few years. The Committee felt the payment of severance of $12 million, enhanced pension of $2 million, and excise tax grossup of $7 million seemed unnecessary (they were okay with accelerating the previously awarded equity incentives valued at $5 million).
        5. Several alternatives were discussed:
            1. Ask the CEO to relinquish his severance contract. (Due to poor drafting of the agreement, a notice of contract cancellation gave the executive good reason to quit and collect 2x salary and bonus in severance.)
            2. Eliminate the excise tax grossup and limit the severance amount to the golden parachute safe harbor.
            3. Grant future equity awards with double trigger vesting.
            4. Amend the contract to include a covenant-not-to-compete to help mitigate the excise tax.
            5. Establish a policy that severance will be reduced $.50 for $1 for every dollar over $20 million the executive has earned through pension and equity incentives throughout his career. (Since he already

earned $50 million, the $12 million in severance would be reduced to zero.)

6. Do nothing for now, and benchmark his payments to amounts reported by peers in their 2007 proxy.

6. As you might have already guessed, the Committee chose 5(f) above.

   1. While anecdotal, this experience confirms what many commentators fear will lead to a new round of benchmarking. For example, what if the CEO's peers are entitled to more severance? How likely is it that the executive will agree to scale back?

   2. The Committee was very reluctant to "change the deal," fearing the executive might quit.

   3. Personally, I like the "lifetime achievement" limitation cited in 5(e) above. Some will argue it penalizes executives for success and perversely pays the greatest amount of severance to the least successful, shortest service executive. On the other hand, it phases out severance for executives that do not need the payments to maintain their lifestyle, (and in all likelihood the lifestyle of their children, grandchildren and beyond). It also initiates a dialog with the Committee on how much wealth the executive compensation program should be targeting under different performance scenarios, as opposed to a year by year analysis of how pay compares to the survey data.

3. **Action Items**

   1. Update tally sheets to support proxy disclosure requirements.

   2. Carefully review termination scenarios for unusual or large payments:

      1. Severance multiples are applied to highest or maximum bonus rather than target or average bonus.

      2. Excise tax grossups, especially where the incremental after tax value to the executive is modest compared to scaling payments back to the safe harbor.

      3. Outstanding awards are paid out at maximum performance or are not prorated for time worked during the performance cycle.

      4. Final average earnings in the pension calculation is significantly increased due to the inclusion of the severance pay.

      5. Additional years of credited service or age unreasonably increase the present value of the pension.

      6. Pension formula includes equity gains in the final average earnings calculation.

      7. Lump sum pension is based on an artificially low discount rate.

      8. Retirement provisions result in full vesting of equity incentives at time of grant.

9. The Company is obligated to provide all benefits, even in a for cause termination.

3. Look at all payments, past and present when reviewing the reasonableness of the termination scenarios.
4. Consider the potential value of existing awards in making current compensation decisions and evaluating the reasonableness of termination payments.
5. Make sure the Company gets value in return for severance payments (e.g., covenant-not-to-compete, non-solicitation of employees and customers, waiver of claims against the Company) and can recoup or stop payments if the executive violates those covenants and restrictions.
6. While "benchmarking" termination payments to peers to test the reasonableness of your arrangements is inevitable, avoid the temptation of using the data to justify expanding benefits.
7. Consider including "lifetime achievement caps" in all severance arrangements.

Here is a sample termination scenario tally sheet.

For more information, contact info@compensationstandards.com or call 925.685.5111.

Tally Sheet Evolution

Moving From Data Display to Decision Making

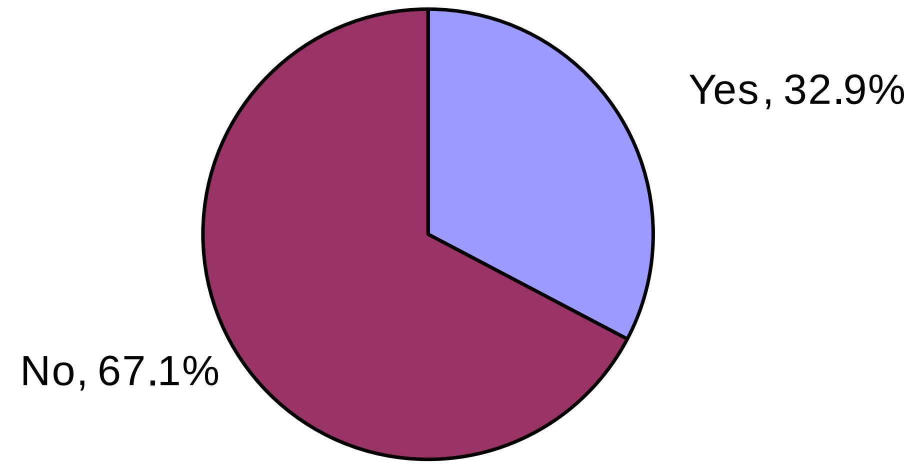
A Quick Evolution

- **2004 – First Discussion of Potential Usefulness**
- **2005 – First Widespread Use**
- **2006 – Becoming More Comprehensive**
- **Done? Or Just Starting?**

What Next?

- **Term Survives**
- **Purpose Changes**
- **Dynamic vs. Static**

Are Your Tally Sheets Dynamic?



Primarily a Reporting, Rather than Analytical Tool

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What Next?

- **Dynamic Tally Sheets**
- **Illustrate Potential Compensation Opportunities Dynamically**
- **Show the Relationship Between Pay and Performance**
- **Simulate Potential Results of Pay Plan**
- **Provide Alternative Views**

What Drives It?

- **Monte Carlo Analysis Linked to a Tally Sheet**
- **Expresses:**
  - Expected Stock Price Appreciation, Probabilities, Distribution of Prices
  - Expected Company Performance, Incentive Plan Payouts, Probabilities
  - Relationship (Correlation) Between Company Performance, Stock Price
- **Expectations, Probabilities, Distributions – Historic or Projected**
- **Software-Generated, 1000's of Trials**
- **Result: Prediction of Combined Values, Distribution of Results**

Case

Elements: Base, Annual Incentive, Restricted Stock, Options
Expected Value, All Elements: $12.3M

Elements: Base, Annual Incentive, Restricted Stock, Options
Expected Value, All Elements: $12.3M

Percentiles		Company Performance								
		10%	20%	30%	40%	50%	60%	70%	80%	90%
Stock Performance	10%	$4,084,033	$4,375,758	$4,586,170	$4,765,959	$4,934,003	$5,186,070	$5,455,754	$5,771,371	$6,208,959
	20%	$6,611,214	$6,902,939	$7,113,350	$7,293,139	$7,461,184	$7,713,250	$7,982,934	$8,298,551	$8,736,139
	30%	$8,433,488	$8,725,213	$8,935,625	$9,115,414	$9,283,459	$9,535,525	$9,805,209	$10,120,826	$10,558,414
	40%	$9,990,555	$10,282,280	$10,492,692	$10,672,481	$10,840,525	$11,092,592	$11,362,275	$11,677,893	$12,115,480
	50%	$11,445,908	$11,737,633	$11,948,045	$12,127,834	$12,295,878	$12,547,945	$12,817,628	$13,133,246	$13,570,833
	60%	$12,901,261	$13,192,986	$13,403,397	$13,583,186	$13,751,231	$14,003,297	$14,272,981	$14,588,598	$15,026,186
	70%	$14,458,327	$14,750,052	$14,960,464	$15,140,253	$15,308,297	$15,560,364	$15,830,048	$16,145,665	$16,583,253
	80%	$16,280,602	$16,572,327	$16,782,739	$16,962,528	$17,130,572	$17,382,639	$17,652,323	$17,967,940	$18,405,528
	90%	$18,807,783	$19,099,508	$19,309,919	$19,489,708	$19,657,753	$19,909,819	$20,179,503	$20,495,120	$20,932,708

Case

Elements: Base, Annual Incentive, Restricted Stock, Options
Expected Value, All Elements: $12.3M

Best "point" estimate of total rewards is $12.3M

Percentiles		Company Performance								
		10%	**20%**	**30%**	**40%**	**50%**	**60%**	**70%**	**80%**	**90%**
Stock Performance	**10%**	$4,084,033	$4,375,758	$4,586,170	$4,765,959	$4,934,003	$5,186,070	$5,455,754	$5,771,371	$6,208,959
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Elements: Base, Annual Incentive, Restricted Stock, Options
Expected Value, All Elements: $12.3M

But if stock, company performance are 10th %ile, is $4.1M appropriate?

Percentiles		Company Performance								
		10%	20%	30%	40%	50%	60%	70%	80%	90%
Stock Performance	10%	$4,084,033	$4,375,758	$4,586,170	$4,765,959	$4,934,003	$5,186,070	$5,455,754	$5,771,371	$6,208,959
	20%	$6,611,214	$6,902,939	$7,113,350	$7,293,139	$7,461,184	$7,713,250	$7,982,934	$8,298,551	$8,736,139
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Case

Elements: Base, Annual Incentive, Restricted Stock, Options
Expected Value, All Elements: $12.3M

Percentiles		Company Performance								
		10%	20%	30%	40%	50%	60%	70%	80%	90%
Stock Performance	10%	$4,084,033	$4,375,758	$4,586,170	$4,765,959	$4,934,003	$5,186,070	$5,455,754	$5,771,371	$6,208,959
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And if stock, company performance is 90th %ile, is $20.9M enough?

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Case

Elements: Base, Annual Incentive, Restricted Stock, Options
Expected Value, All Elements: $12.3M

Percentiles		Company Performance								
		10%	20%	30%	40%	50%	60%	70%	80%	90%
Stock Performance	10%	$4,084,033	$4,375,758	$4,586,170	$4,765,959	$4,934,003	$5,186,070	$5,455,754	$5,771,371	$6,208,959
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Or if company performs poorly, but stock takes off, is $18.8M good?

Today, Focus is Expected Value – or Maybe a Range, Element by Element

Percentiles		Company Performance								
		10%	20%	30%	40%	50%	60%	70%	80%	90%
Stock Performance	10%	$4,084,033	$4,375,758	$4,586,170	$4,765,959	$4,934,003	$5,186,070	$5,455,754	$5,771,371	$6,208,959
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Case

Today, Focus is Expected Value – or Maybe a Range, Element by Element

But the Focus Should be on the Range of Combined Outcomes, by Performance Level

Percentiles		Company Performance								
		10%	20%	30%	40%	50%	60%	70%	80%	90%
Stock Performance	10%	$4,084,033	$4,375,758	$4,586,170	$4,765,959	$4,934,003	$5,186,070	$5,455,754	$5,771,371	$6,208,959
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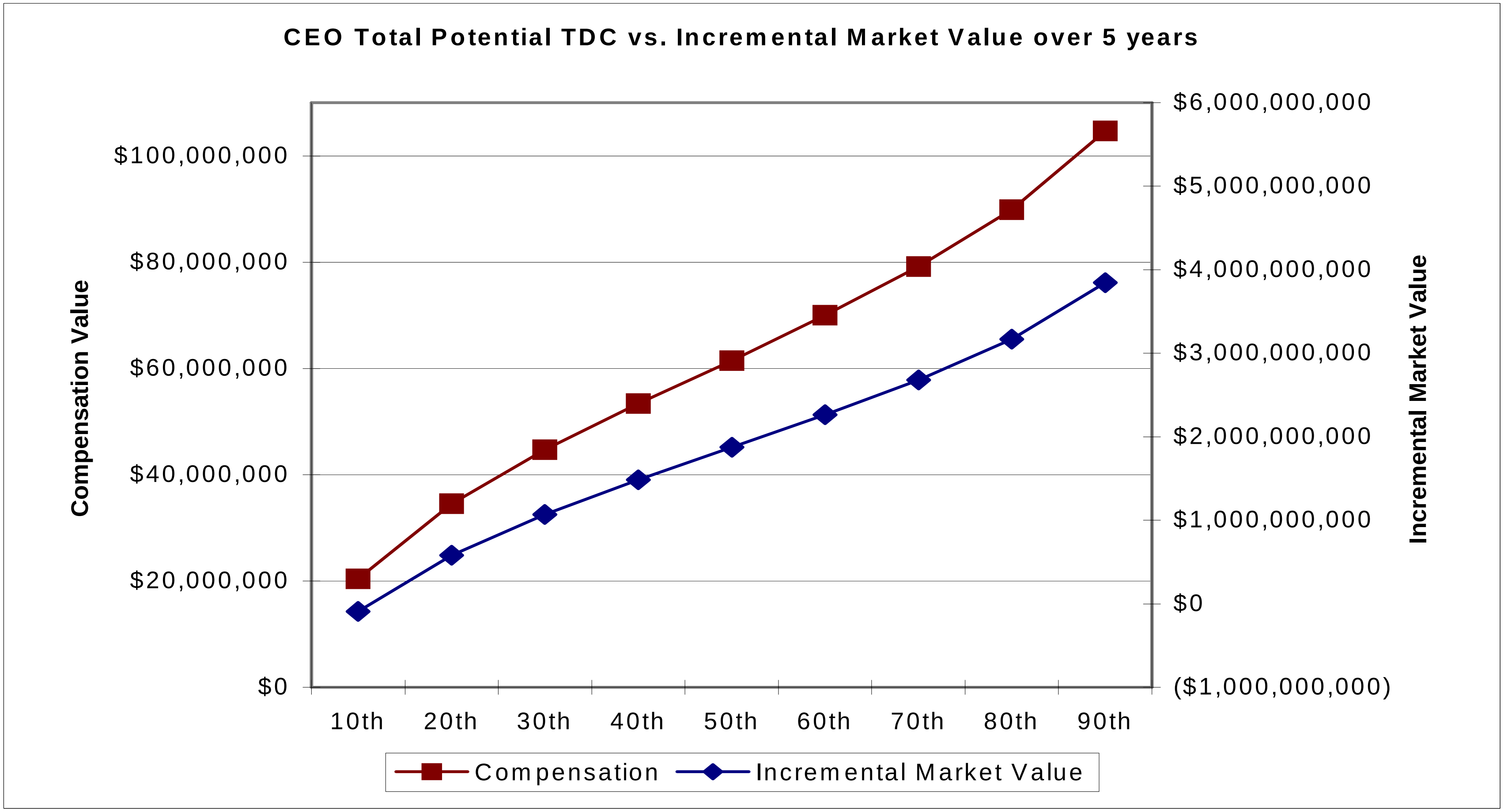
Pay vs. Performance



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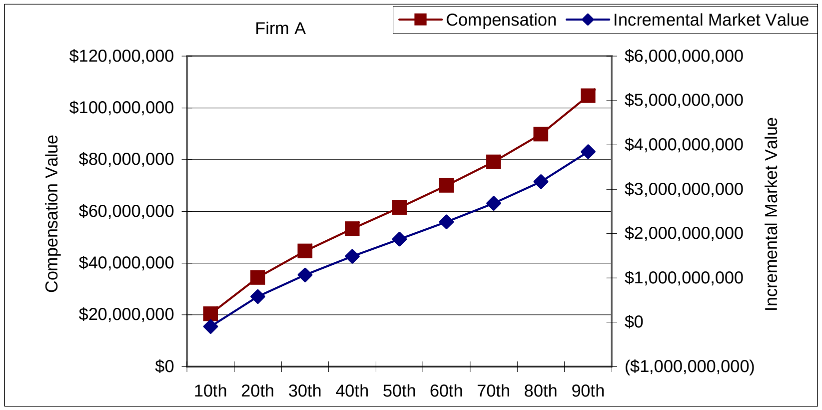
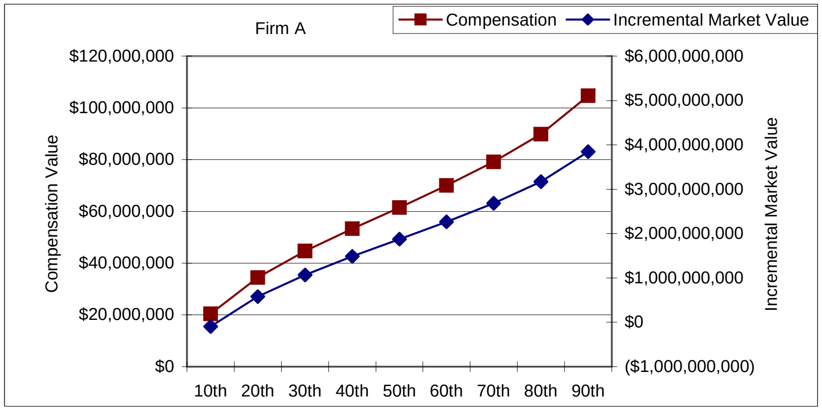
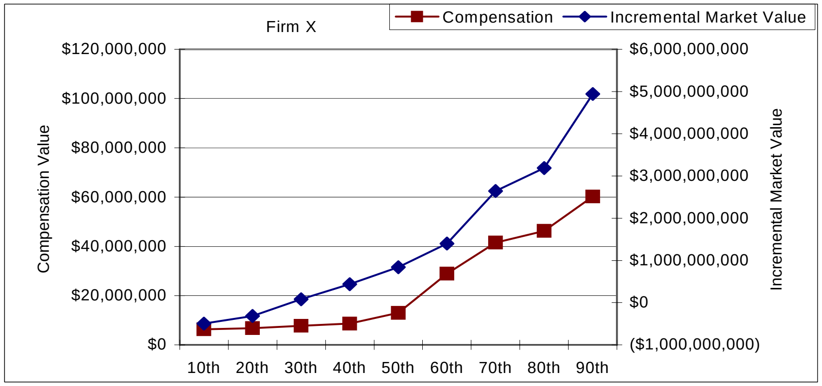
Comparing Three Profiles

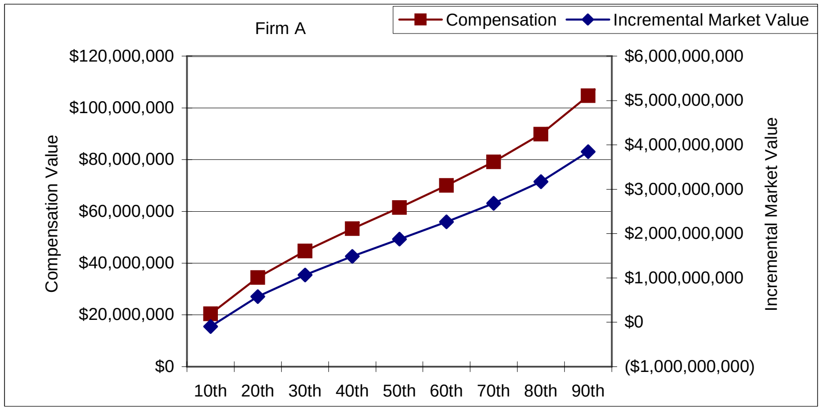


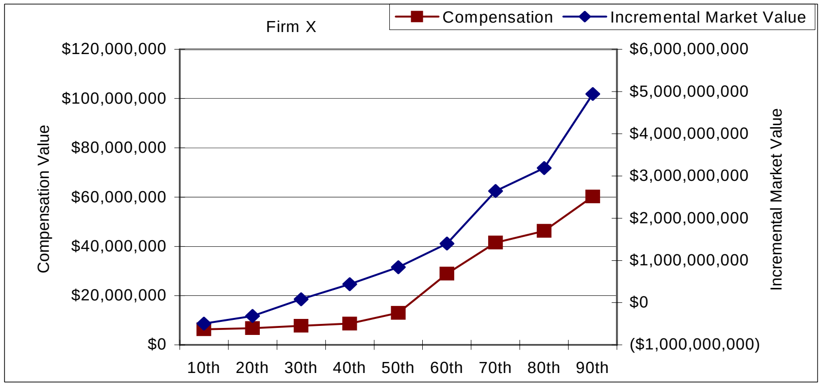
Comparing Three Profiles

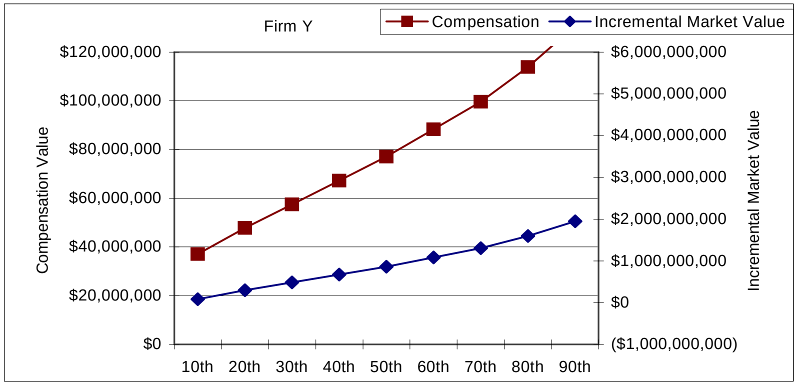




Comparing Three Profiles







So What Next

- **Committees Being Asked…**
  - Relationship between pay and performance?
  - How much is too much?

- **Dynamic Tally Sheets Provide Insight, Not Answers**

- **Changes Role from Data Display to Decision Tool**

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Talking Points: Accumulated Wealth Analysis

Doug Friske

Managing Principal

October 11, 2006

Accumulated Wealth Tables Defined

- Analyses that look at past, present and future value generated by all company-sponsored rewards
  - Past equity grants
  - Future cash compensation
  - Future equity grants
  - Pension/defined contribution plans
- While approaches vary, desired outcome is the same
  - Understand the total wealth potential of all past and future compensation and benefit plans
- In essence, it represents a projection of what future proxy disclosures might look like under current plan designs

Accumulated Wealth Tables Examples

- Wealth accumulation analyses should start off by establishing a baseline for what is in place today
  - Primary focus is on equity and retirement benefits

	Wealth Accumulation Today ($millions)					
Name	Total Cash Compensation[1]	Current Equity Holdings ($M)[2]	Value of Shares Sold Past 5 Years ($M)[3]	Future LTI Grants[4]	Retirement Benefits[5]	Total
Executive A	$2.6	$15.0	$0.0	N/A	$0.6	$18.2
Executive B	$1.6	$7.0	$3.0	N/A	$0.3	$11.9
Executive C	$1.3	$8.0	$1.2	N/A	$0.3	$10.8
Executive D	$1.0	$5.0	$0.5	N/A	$0.1	$6.6

(1) Equals current base salary plus 2006 target annual incentives.

(2) Current holdings includes vested and unvested stock options and restricted shares.

(3) Represents the realized value, before taxes, of any shares sold between 12/31/01 and 12/31/06

(4) Not applicable as shows wealth accumulation as of 12/31/06.

(5) Includes total balance of 401(k) and deferred compensation plans.

Accumulated Wealth Tables Examples (cont'd)

- Projections should then be made to determine what wealth accumulation will look like in the future
  - Suggests what proxy might show in five years (or any other point in time)

	Estimated Value at 12/31/11 ($millions)							
Name	Total Cash Compensation[1]	Current Equity Holdings in Total ($M)[2]	Increase in Value of Current Equity Holdings ($M)[3]	Value of Shares Sold as of 12/31/06[4]	Future LTI Grants[5,6]	Retirement Benefits[7]	Total Value Using Final Equity Value	Total Value Using Incremental Equity Value
Executive A	$14.2	$25.0	$10.0	$0.0	$8.0	$1.0	$48.2	$33.2
Executive B	$8.7	$11.3	$4.3	$4.8	$4.7	$0.5	$30.0	$20.0
Executive C	$7.1	$12.9	$4.9	$1.9	$3.4	$0.5	$25.7	$16.5
Executive D	$5.5	$8.1	$3.1	$0.8	$1.6	$0.2	$15.3	$10.6

(1) Equals the sum of base salary and 2006 target bonus based on current base salary and target annual incentive % grown at 3% over 5 years (does not include any additional interest).

(2) Current holdings includes vested and unvested stock options and restricted shares.

(3) Only includes the incremental growth in equity value from 12/31/06 to 12/31/11.

(4) Represents the realized value, before taxes, of any shares sold between 12/31/01 and 12/31/06, assuming subsequent growth in equity value.

(5) Assumes annual 3% per year growth in the expected value of LTI grants.

(6) Assumes 75% of the target share award vests and 40% of the vested shares are sold to pay taxes.

(7) Only includes employer-related balances. Assumes 3% annual growth in 401(k) and Deferred Compensation balances per year with ongoing employer contributions equal to those made in 2005. Represents total, not incremental, value.

Accumulated Wealth Tables Examples (cont'd)

- Ultimately, the incremental wealth creation for executives should be compared to that realized by shareholders

	Estimated Value at 12/31/11 ($millions)				
Name	Total Future Wealth[1]	Incremental Future Wealth[2]	Market Cap 5 Year Growth[3]	Individual's Total Wealth Creation as a % of Shareholder Value Created[4]	Individual's Incremental Wealth Creation as a % of Shareholder Value Created[5]
Executive A	$48.2	$33.2		1.20%	0.83%
Executive B	$30.0	$20.0		0.75%	0.50%
Executive C	$25.7	$16.5	$4,000.0	0.64%	0.41%
Executive D	$15.3	$10.6		0.38%	0.27%
Total	**$119.3**	**$80.4**		**2.98%**	**2.01%**

(1) Includes expected value of current equity holdings, future equity grants, retirement benefits and total cash compensation.
(2) Includes incremental growth in current equity holdings and expected value of future equity grants, retirement benefits and total cash compensation.
(3) Based on market cap as of 12/31/06 with a growth rate of 8% over 5 years (assuming no change in shares outstanding).
(4) Equals the individual's total future wealth expressed as a percentage of market cap growth over a 5-year period.
(5) Equals the individual's incremental future wealth expressed as a percentage of market cap growth over a 5-year period.

How the Accumulated Wealth Tables Have Evolved

- Inclusion of:
  - Future cash compensation
  - Assessment of total shareholder value creation, and sharing rate with executives
  - Dividends earned
  - Realized value of shares previously granted
- CD&A requirements may drive future evolution
  - Direct connection to annual compensation (i.e., was wealth accumulation considered in annual pay decisions)
  - Internal equity consideration

Common Issues with Accumulated Wealth Tables

- Treatment of past equity grants
- Validity and accuracy of future projections (e.g., equity grants, stock price appreciation)
- Role of employee-contributed funds (e.g., deferred compensation balances, defined contribution accounts)
- Linkage with shareholder value creation
- Interpretation of findings
  - Benchmarking?

How Employers Use the Accumulated Wealth Tables for Executive Pay Decisions

- Recent survey suggests significant amount of change
  - Over 90% of companies use tally sheets, often with some form of wealth accumulation analysis
  - Over 40% of directors say they have taken actions or plan to take actions in the following areas:
    - Overall pay/benefit levels
    - Severance benefits (normal severance and severance following a change of control)
    - Cost of benefits/perqs

How Employers Use the Accumulated Wealth Tables for Executive Pay Decisions (cont'd)

- However, practical experience suggests change has been more gradual
  - Change has been at the margin, eliminating outliers; mainstream practices remain largely unchanged
- Survey Source: 2006 Executive & Director Compensation Survey, Corporate Board Member Magazine

Application of the Accumulated Wealth Tables in the 2007 Proxy Disclosure

- No single area of focus; elements spread throughout the proxy:
  - Outstanding stock options
  - Other share plans
  - Beneficial ownership
  - Pension values
  - Deferred compensation/401(k) values
- Compensation Discussion & Analysis may be a focal point
  - Need to discuss how value of programs in total and in aggregate are considered in ongoing compensation discussions
  - Impact is likely to be felt over time

Going Forward with Accumulated Wealth Tables

- Will continue to evolve as companies gain experience with the issues and practices become more standardized
- Projections will be fine-tuned to make them more meaningful relative to future proxy disclosures
  - Stock performance
  - Share holdings
  - Expected tenure
- Treatment of past stock sales will be clarified
  - Defined period of time (e.g., past five years)
  - Current role only

Going Forward with Accumulated Wealth Tables (cont'd)

- Key question is will/how should plan designs and pay decisions evolve going forward in light of the analysis
- Actions to adopt
  - Review executive rewards holistically
  - Discuss appropriate actions in light of company-specific factors
  - Consider analysis in light of anticipated future disclosures
- Actions to avoid
  - Adopt arbitrary caps or limits
  - Rely on external benchmarks to determine reasonableness

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NASPP

October 12, 2006

How to Create and Implement a Wealth Accumulation Table:

What Directors Now Need To Address

Mike Halloran
Worldwide Partner

MMC Marsh & McLennan Companies

Today's Discussion

- What are they
- What can/should be covered
- How are they developed
- How can they be used
- Implications and cautions

Accumulated Wealth Tables - - What are they?

- Tables created to show the values created by both the various parts of the total compensation program, as well as by the program as a whole
- Creates a measurement to assess the effectiveness of a company's programs in achieving defined objectives (or in establishing objectives)
- Can be used to project outcomes that may impact future disclosure

Accumulated Wealth Tables - - What can/should be covered?

- Can and should cover all major elements of total compensation, especially those that create wealth
  - Annual bonuses
  - Equity awards
  - Non-equity, longer-term cash awards
  - Retirement programs
  - Deferred compensation
- Other elements such as base salary can logically be included
- Can be both historic and futuristic in nature

Accumulated Wealth Tables - - How are they developed?

- Collect relevant data on key elements
  - Current and historic levels/grants
  - Historic and future rates of growth, range of outcomes, etc.
  - Relevant company demographics (e.g., promotion rates)
- Determine relevant time frame(s) to examine
  - Historic
  - Future
- Identify relevant assumptions and/or ranges of assumptions
  - Growth rates: compensation, stock price, interest rates
  - Variations in the above due to performance and other factors

Accumulated Wealth Tables - - How can they be used?

- To test the reasonableness of today's decisions from both an internal and an external perspective
- To determine the achievement of pre-established company/program objectives
- Assess internal equity, near-term and longer term
- Create path for integrating new, senior hires
- Provide a context for assessing the impact of plan design decisions
- Proved a context for assessing the balance between executive wealth, increased shareholder wealth and company performance

Accumulated Wealth Tables - - Implications and Cautions

- The tables are an additional tool that can be helpful, but are not stand-alone materials
- Assumptions are critical
- Cross-company comparisons are directionally correct at best
- Use reasonable timeframes
- Accuracy should not be over-emphasized

Talking Points: What Still Needs Fixing: Annual Long-Term Incentive Grant Practices and Change-In-Control Agreements (10/12/06)

Don Delves is President and Founder of The Delves Group

Annual Long-Term Incentive Grant Practices

- Long-term incentives are not an annual event. They are a cumulative process and must be viewed as such.
- The fact is, equity incentives work, but they work because of their cumulative effect, not just because of the most recent grant.
- The objective is not just compensation, but motivation. We are trying to alter executives' natural risk (or non-risk) orientation. We are trying to change their wealth portfolio and alter their personal financial risk so that they will make decisions that are in the best interest of the owners.
- We do this by creating a **balanced long-term incentive portfolio**. This is a mix of shares owned, performance-based stock, restricted stock and options.
- The portfolio has to be the right size AND the right mix. As we learned in the 1990's, if we grant too many options, they will take too much risk. However, I have seen cases where executives own so much stock that they stop taking risks altogether.
- There is a point where an executive has enough equity grants, where his or her portfolio is full and balanced and where additional grants really won't accomplish much more in terms of motivation.

Change-In-Control Agreements

- Golden parachutes are mostly unnecessary and are the aspect of executive pay that most offends investors and the public.
- They are one of the worst vestiges of a by-gone era of excess and privilege.
- It has become an entitlement that many executives get rich just because the company they work for is sold and they lose their job.
- There are two legitimate reasons for change-in-control agreements:
  - A CEO or other very senior executive who is hired into a difficult situation.
  - A company is in play and you need to retain key people – and/or you want to give them an incentive to sell at the best possible price.
- However, in neither case is the typical three-times-everything-plus-a-gross-up deal necessary
  - The hired-gun CEO will be quite well protected with a two-times deal and no gross up.
  - If the company is in play, current long-term incentives should be more than adequate to provide the needed incentive to stay and maximize the sale price – especially if they all vest at the change in control. If not, grant more shares.
- Remember, not all companies have change in control agreements. Many organizations find them offensive and have policies against them.
- Unfortunately, getting rid of lucrative golden parachutes once they are in place is like getting the proverbial genie back in the bottle.
  - If you have them, gradually scale them back as new executives are hired or promoted (e.g., no new parachutes, or all new parachutes are less lucrative)
  - If you don't have them, don't adopt them.

Talking Points: What Still Needs Fixing: Higher Disclosure Standards and Post-Retirement Provisions (10/12/06)

Brian Foley is Manager Director of Brian Foley & Company, Inc.

Should a Higher Standard Be Set for Proxy Disclosures on Executive Compensation Levels & Practices? Addressing Key Items that Were MIA in the New SEC Rules: Eight Specific Items to Think About

The newly promulgated SEC proxy rules in general provide for various quantum improvements in the proxy disclosure rules applicable to executive compensation by substantially improving the scope, quality and content/detail of future executive compensation disclosures.

Unfortunately, the new rules do not go far enough or go awry in several important areas – creating, in our view, the opportunity for companies at the leading edge of best disclosure practices to consider the question of whether and to what extent to address such "MIA" items and apply an even higher, better standard of proxy disclosure.

The items from the "MIA list" that could/should be looked at and considered include, among others, the following key items:

1. Full 3-year Summary Compensation Table disclosures starting in 2007 vs. the permitted one-year phased-in approach which would create substantial year over year comparability issues.

2. Separate meaningful proxy disclosure of any material actions/events involving NEO pay that occur in Q1 of the current year prior to the mailing of the proxy statement.

    - An important subset of this is that merger proxy disclosures should separately identify and value any executive officer compensation and benefit items arising after the end of the most recently completed year covered by the last regular annual proxy statement.
    - Summary disclosure of status/value of LTIP award opportunities for all cycles still in progress that started prior to the last completed year covered by the Summary Compensation Table in the proxy statement being filed.
    - Full footnote disclosure of the amount of dividends paid with respect to restricted stock, unvested RSU awards and unvested performance share awards or other unvested stock awards – itemizing what is paid as current cash/shares vs. restricted cash/shares vs. deferred cash/shares.
    - At least for the CEO and CFO (the two executive officers certifying the financial statements), (i) a cumulative tally of all amounts realized with respect to long-term incentives (including all amounts realized on stock option / SAR exercises, the vesting of restricted stock, the payout of RSUs or performance shares and the payout of LTIPs) over the last five years or over their full career in such position or as an NEO, plus (ii) the cumulative value of any vested but deferred awards (not yet taxed) not otherwise reported in the current proxy statement, and (ii) a better/clear disclosure of the number of shares actually retained (still held) with respect to prior option/ SAR exercises, restricted stock / RSU vesting/payout events and LTIP payouts made in shares.
    - Disclosure of the size of the employer-funded portion of tax-qualified defined contribution plan account balances.
    - Full disclosure of the impact of financial restatements on annual bonus and other NEO incentive pay actions taken in years covered by such restatements - in particular as they relate to the CEO, the CFO and any other NEO directly involved in such restatements.
    - Identifying the existence of, and total amounts paid for, any work performed for management (vs. the Compensation Committee) by the Committee's compensation consultant (or any colleague, parent, subsidiary or other affiliate).

What May Still Need to Be Done with Respect to SERPs from Both a Design & CD&A Standpoint: Five Hot Spots

As a general rule, SERP, severance and other post-employment provisions relating to NEOs should be carefully reviewed annually on a fresh look / clean slate basis from the standpoints of current need, current appropriateness and updated projected cost. This is all the more true this year in connection with the preparations for next year's CD&A disclosures.

In the spirit of taking a related fresh look at SERP-related plan, program and practice design and disclosure issues, we note the following items as things that need to carefully evaluated and justified going forward.

A SERP by any other name. . .

A well designed and well implemented SERP can play an important and appropriate role in a CEO's or NEO's overall compensation and benefits package, but a number of SERPs have been amended over the years in ways that take the actual benefits away from their roots and lead to questionable or even ugly results.

Five possible SERP hot spots, among other, that should be looked at now from a program/practice design standpoint and certainly from the standpoint of putting the company's best foot forward in the upcoming CD&A disclosures include:

1. **<u>The overloading of pensionable compensation</u>** – The problems/disconnects that often arise when SERP benefit formulas treat as pensionable not only base salary and annual bonus, but also other big items not traditionally or appropriately viewed as pensionable such as freestanding stock option and SAR gains, restricted stock and RSU awards or payouts, and/or LTIP payouts – with the result in some of the more egregious situations that a CEO's final SERP benefit exceeds 75% and even 100% of his or her actual average base salary and annual bonus prior to retirement. . .

    - Note possible distinctions between freestanding long-term awards and limited situations where executive elects to convert reasonable earned annual bonus into a long-term award.

What May Still Need to Be Done with Respect to SERPs. . .

2. **<u>The bigger-wave-within-a-big-wave SERP problem with late-in-career super bonuses</u>** – The problems/ disconnects that arise when SERP benefits spike due to the inclusion of extraordinary annual bonuses paid in the last 1-2-3 years of employment, where the value of the SERP benefit spike outstrips or far outstrips the initial extraordinary size of the annual bonus -- producing a secondary, often hidden cost wave far larger than the sizable wave caused by the initial bonus itself. . .

3. **<u>The cherry-picking of pensionable compensation</u>** – The problems/disconnects that, depending on the circumstances, may arise when pensionable compensation is defined (i) by reference to the highest single year in a period, or (ii) by cherry picking compensation from the highest non-consecutive years in a period vs. a simple average based on a 3-consecutive-year/36-consecutive-month period or 5- consecutive year/60-consecutive-month period, or (iii) by reference to assumed maximum compensation levels during a specified post-employment severance period – particularly if the Compensation Committee is not keeping tabs on, and fully taking into account, where the numbers are and could end up.

4. **<u>Possible over-subsidization of early retirements</u>** – The problems/disconnects that, depending on the circumstances, can arise, e.g., when the CEO or other selected senior executives can early retire with fully subsidized <u>unreduced</u> jumbo size retirement benefits prior to the age that other employees can do so (without the jumbo) – particularly if it's prior to age 60.

5. **<u>Playing with the service component in SERP formulas</u>** - The range of problems/disconnects that, depending on the circumstances, can arise when the normal cap on credited service that applies to other employees is waived for the CEO and other selected senior executives, and/or substantial deemed service credits are provided without sufficient strings attached

Brian Foley & Company, Inc.

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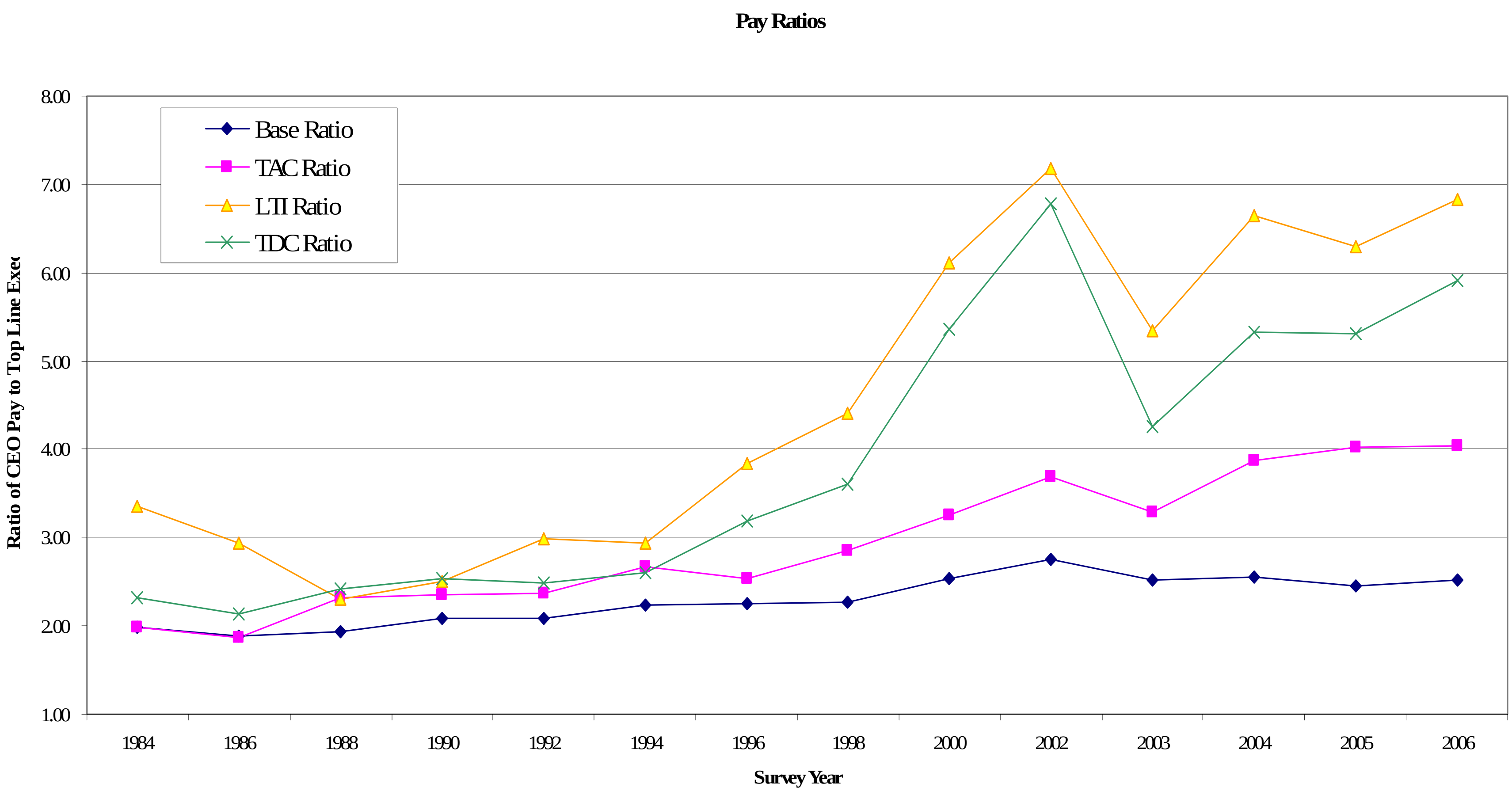

Talking Points: Why - and How to - Implement Internal Pay Equity? (10/12/06)

Fred Cook, Frederic W. Cook & Co. and Blair Jones, Semler Brossy Consulting Group

What is Internal Pay Equity?

1. Target ratio of CEO compensation to compensation of senior line executives (group or division presidents)
   - Cash compensation ratio to cash compensation
   - Total compensation ratio to total compensation (taking into account executive benefits)
2. Also called **"Proportional Pay"**
3. It also may compare ratios of CEO to COO to Group/Div. CEOs
4. It is not ratio of CEO pay to average or lowest-paid employee
5. Neither is it the same ratio for every company. The right ratio will depend on a company's unique circumstances and may change as the company's circumstances change

Why Use It?

1. Helps correct the long-term bias in pay surveys that have raised CEO and top staff executives' pay at a faster rate than line executives, and allows more focus on what the right relationship is for a given company's circumstances
   - Trend to market pricing all positions, and slavishly following surveys to determine the "value" of executive positions, has gone too far,
   - Use and abuse of surveys has led to escalating CEO pay ratios without any other justification
2. Provides, in combination with external surveys, a more balanced approach to determining pay guidelines for top executive positions
   - Mitigates biases in the marketplace that may favor certain positions but do not reflect their relative importance internally
   - Consistent with the 2nd Key Principle in NACD's Blue Ribbon Report: "Fairness" -internally, as well as

externally

3. Places more emphasis on CEO pay as part of the overall “cost of management”
4. Allows companies to reflect company specific characteristics such as:
   - The internal value of the CEO's leadership style relative to other executives (e.g., "value creator" vs. team leader)
   - Organizational structure (e.g., flat vs. multiple levels; presence or absence of COO; relative number of general managers)
   - Strength of line management team
5. Provides additional, thoughtful logic and support to pay positioning for disclosure purposes
6. Leads to better employee relations and a stronger, more cohesive, company

How To Use It?

1. Track the company's internal pay ratios between CEO and direct line reports historically
2. If CEO pay ratio has risen disproportionately relative to other line executives, assess whether this is justified by internal factors or has occurred merely by slavish adherence to surveys
3. Set a ratio appropriate for your company here and now – for target annual compensation and total compensation
4. Set appropriate and competitive total compensation structure for senior line executives
5. Then, layer CEO and COO above that level, based on historical relationships or common sense, e.g., CEO/COO/EVP of 100/75/60-50
6. Mix of pay elements may vary between levels, but need not

Avoiding Unintended Consequences

1. Develop clear criteria for determining right multiple to avoid “multiple envy”
2. Establish clear protocol for how senior line executives’ pay levels will be determined to avoid total compensation “creep” for all
3. Determine how far Board is willing to let CEO pay levels fall out of synch with “market” before re-evaluating relative pay levels
4. Be open to adjusting ratio as management structure and individual incumbents change

5. Continuously evaluate "cost of management" and executive/shareholder value sharing

For more information, contact info@compensationstandards.com or call 925.685.5111.

Talking Points: How to Fix Outstanding CEO Pay Packages and Agreements (10/12/06)

Michael Melbinger, Winston & Strawn and Tim Sparks, Compensia

Why must the Compensation Committee fix existing arrangements?

For the protection of the Board, the compensation committee, the CEO, and the Company's public image, the Compensation Committee should re-examine all existing arrangements. They must understand and be able to write in the minutes and proxy statement that they understand each element of the CEO's compensation package, the value of the package under expected scenarios, and the potential value of the package under unexpected scenarios.

1. Better late than never. A compensation committee that takes the bull by the horns and actually fix their past mistakes (which, may require rolling back excessive grants and pay packages) will have a powerful good faith defense, pointing out that it was not until now that someone pulled it all together in one place and made clear what needs to be looked for and addressed by every diligent compensation committee.
2. New Executive and Director Compensation Disclosure Rules will make it even easier for investors and the media to understand every element of the compensation package.
3. Potential liability for not acting. If a court were to find that directors permitted a CEO to receive millions of dollars in excessive compensation by failing to meet minimal standards of due care by not considering basic information, such as the aggregate costs of a pay package, including severance costs, a court might find that the board abrogated its duties to the company and failed to act in good faith. This could mean that each director would have to pay out of his or her own pocket - without being reimbursed by the company or the D&O insurance carrier - several million dollars each.
4. Neither the executives nor the compensation committee members are well served by unrecognized components of compensation. As a best practice, the CEO should meet with the compensation committee and go through the tally sheet, with the assistance of any internal or external experts necessary to fully explain each component.
5. Directors should not be embarrassed that they don't understand all of the intricacies of an employment

agreement, change in control agreement, deferred compensation plan or SERP. These can be very complicated. Let's face it, that is why many of us in this room have jobs, because it takes someone who has specialized in looking at, drafting and negotiating these things for twenty plus years. It is the rare compensation committee that has the requisite expertise to make complicated analyses – which now should be more complicated as more performance-based compensation is used - on their own.

How should the Compensation Committee go about re-examining existing arrangements?

- Step One – Establish a framework and process for thoughtful, informed (and motivated) decision making.

1. Get it on the calendar – the Compensation Committee should periodically review existing arrangements, allowing ample time for education, analysis and deliberation
2. Review the Compensation Committee Charter and related decision rights
3. Education – to help "set the stage" for appropriate action the Compensation Committee needs to be kept apprised of recent developments, trends and best practices concerning executive compensation and Committee operations
    1. SEC disclosure rules
    2. Recent litigation and SEC enforcement actions
    3. Tools to facilitate thoughtful and informed decision-making (e.g., tally sheets, internal equity analysis, wealth accumulation targets, etc.)
    4. Good governance best practices:
        1. Independent advisor(s)
        2. Executive sessions after every meeting
        3. Committee composition – independence, competencies, commitment
    5. Shareholder climate
    6. Key elements of executive contracts:
        1. Contract term/renewal provisions
        2. Cause
        3. Constructive termination (e.g., "good reason" and "walking windows")
        4. Change-of-control
        5. 280G – gross ups, etc.

        6. Restrictive covenants – non-compete, non-solicit, etc.

    7. Other legislative and regulatory developments – tax, accounting, etc.

4. Compensation philosophy/guiding principles – from time to time the Committee should review (with management) the company's compensation philosophy/guiding principles and revise as appropriate.

5. Understand the competitive environment – historically it was not uncommon for "competitive market studies" relating to executive pay and executive contracts to be developed by management and/or their advisors. Not surprisingly, this led to a skewed, piecemeal and/or anecdotal presentation of the competitive environment. To combat these biases, Compensation Committees should take market data "with a grain of salt" and use such data only as a reference point. Common sense, informed deliberation, good judgment and adherence to the company's compensation philosophy/guiding principles should drive decision making.

6. Develop tools to assess executive pay and executive contracts thoughtfully and holistically

    1. Tally sheets – base, bonus, equity, perquisites, retirement plans (SERPS),

    2. Equity profiles – current equity holdings and their associated (intrinsic) value – vested and unvested, as well as recent/historical value realized (option exercises, restricted stock vesting, sales, etc.

    3. Pay/performance analysis – review recent and longer-term pay (by element) against company performance. Confirm that pay is aligned with performance objectives and pay positioning.

    4. Identify, understand and quantify other benefits, such as perquisites, tax gross-ups, special retirement benefits, etc.

7. Understand existing executive pay arrangements – contracts and other agreements (employment agreements, change-in-control agreements, severance agreements, SERPs) – who is covered and what do they say?

    1. Understand the circumstances under which benefits are paid:

        1. Change-of-control – single trigger or double trigger

        2. Terminations unrelated to change-of-control

        3. Benefit formulas – accelerated vesting, cash payout (multiple of base and/or bonus), continuation of benefits and perquisites, post-employment "consulting" arrangements, etc.

        4. Key definitions - "change-of-control," "cause" and "good reason"

        5. Contract term and renewal provisions

        6. Treatment of “golden parachute” excise taxes under IRC 280G
        7. Restrictive covenants – non-compete, non-solicit
    2. Review recent SEC filings to confirm accuracy and transparency of existing arrangements
    3. Calculate costs/benefits under executive contracts - cash, equity and other benefits under different scenarios – termination (with and without cause), voluntary resignation (with and without good reason) and change-of-control
    4. Consider the impact of recent shift and/or increased use of restricted stock/units on payouts
    5. Understand the impact of a change-of-control (and/or employment termination) on performance awards (e.g., equity awards with performance-based vesting)
    6. Compare economic benefits and costs (to employee and company) under different stock price assumptions
    7. Review payouts at the individual and aggregate levels
8. Prepare mock-ups of SEC disclosure tables – presentation of existing arrangements in tabular form as required under the new SEC disclosure rules can be very enlightening and can help to motivate the Compensation Committee to appropriate action.
    1. Understanding the total “value” of compensation to be disclosed to shareholders (and the public)
    2. Post-employment arrangements, such as severance and change-of-control

- **Step two** - discussion and deliberation. Are the amounts, terms and structure appropriate? Are they consistent with the company’s compensation philosophy Some Boards/Compensation Committees may conclude that the amounts and terms are appropriate and be satisfied that they have discharged their fiduciary duty to shareholders by studying the issue.
- **Step three** - devise and propose revisions to executive pay/contracts.

1. Fixing and “cause,” “good reason” and related provisions (employment and all other compensation agreements)
2. Fixing and adding claw backs (employment and all other compensation agreements)
3. Reducing or eliminate perquisites, gross-ups, etc.
4. Eliminate 280G and other tax gross-up provisions
5. Eliminate single trigger change-of-control provisions (i.e., in favor of double trigger)

6. Revise severance/change-of-control benefit formulas:

    - Eliminate/revise bonus payout formula
    - Moderate vesting acceleration (e.g., consider something less than 100% acceleration, particularly with regard to full value shares, such as restricted stock/units and performance awards)
    - Eliminate post-employment consulting provisions
    - Eliminate post-employment perquisite arrangements (e.g., travel, housing, security)
    - Eliminate SERP enhancements

-

Specific strategies for fixing packages and agreements

1. The new CD&A process is the perfect time to introduce (or re-introduce) the subject of roll backs. The process of asking and answering the SEC's questions for Compensation Committees should point to some obvious areas for reform.
2. Annual pay decisions (base, bonus, long-term incentives) are “easier to address” than contractual commitments.
    - Leverage compensation philosophy – pay positioning, performance analysis, internal equity, philosophy around perquisites
    - Disclosure – leverage new disclosure rules to drive better decision making. Mock-ups of required proxy disclosure help to highlight areas of concern and likely shareholder pushback, particularly with regard to perquisites, change of control and severance benefits and 162(m) costs
3. Dealing with contracts – cannot be amended unilaterally. May be particularly challenging when there are multiple executives and/or automatic renewal provisions; reason by no contract or contract with limited terms are preferable
    - Carve out future awards – to mitigate accelerated vesting and/or golden parachute gross-up
        - Options vs. restricted stock, performance shares
        - Modify annual bonus plan
        - Condition future awards on contract modification
    - Negotiate – eliminate gross-up in favor of more vesting, higher salary multiple, etc.,
        - Consider introducing benefit caps – e.g., severance pay, 280G gross-ups

4. Consider substituting more acceptable perks and benefits for egregious ones.

For more information, contact info@compensationstandards.com or call 925.685.5111.