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EXECUTIVE COMPENSATION UPDATES 8:30 AM

Ted Buyniski, Radford Consulting

Maurice Jones, The Manitowoc Company, Inc.

Michael Kesner, Deloitte Consulting LLP

Patrick McGurn, RiskMetrics Group

Jay Rothman, Foley & Lardner LLP

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TED BUYNISKI
SENIOR VICE PRESIDENT
Radford Consulting

Ted Buyniski has more than 25 years of tax, legal and human resources experience. He is a leading practitioner in the areas of executive compensation, equity, and corporate governance. For more than a decade, his practice has focused on serving domestic and global clients in the high technology and life science communities, particularly software, semiconductor, and medical device companies.

Prior to joining Radford Surveys + Consulting, Ted led the high technology compensation practice for Mellon Human Resources and Investor Solutions, managed the East Coast practice of iQuantic; oversaw the compensation function for AlliedSignal (now Honeywell); and practiced law as a tax attorney.

Ted earned a bachelor of science in foreign service from Edmund A. Walsh School of Foreign Service at Georgetown University and a juris doctorate from Boston University School of Law. In addition, to being a member of the Massachusetts Bar, he is a certified employee benefits specialist, and served on the FASB's Equity Expensing Roundtable. Ted regularly contributes to industry and business publications and is a frequent speaker on compensation topics. He is based in Boston.

MAURICE JONES
SENIOR VICE PRESIDENT, GENERAL COUNSEL AND SECRETARY
The Manitowoc Company, Inc.

Maurice D. Jones is the Senior Vice President, General Counsel and Secretary of The Manitowoc Company, Inc. (NYSE:MTW). Previous to joining The Manitowoc Company in 1999 as its General Counsel, Maurice served as legal counsel to Banta Corporation and was a shareholder of the Milwaukee-based firm, Davis & Kuelthau, s.c. Maurice's practice at Davis & Kuelthau focused on mergers and acquisitions, commercial transactions and general business. Maurice received his Juris Doctor degree, cum laude, from the University of Illinois College of Law in 1988. He received his Bachelor of Science degree, magna cum laude, from Brigham Young University in 1984 where he majored in accounting. Maurice is 48 years old, married and has 5 children (ages 13 to 23). Maurice spends a considerable amount of time in volunteer service for the Church of Jesus Christ of Latter-day Saints and spent two years as a volunteer missionary for the Church of Jesus Christ of Latter-day Saints in Uruguay.

MICHAEL KESNER
PRINCIPAL
Deloitte Consulting LLP

Mike is a principal in Deloitte's Executive Compensation practice. He has over 29 years' experience working with companies on a wide range of executive compensation issues, including: assessment of competitive pay levels, recruitment and retention arrangements, incentive compensation plan design, supplemental executive retirement programs, executive employment agreements, benefit security techniques, executive severance benefits, board of directors compensation, deferred compensation plans, and change-in-control pay issues.

He is the independent advisor to the Compensation Committee of the Board of Directors on executive compensation matters at several Fortune 500 companies. He has authored articles published in the Harvard Business Review, CFO Magazine, Directors and Boards, National Association of Corporate Directors' newsletter, and served on the NACD's Blue Ribbon Commission on executive pay. He is also a co-author of a chapter in A Practical Guide to SEC Proxy and Compensation Rules. He has often been a guest speaker on compensation and benefit matters at conferences sponsored by the National Association of Stock Plan Professionals, CompensationStandards.com, National Directors Institute, American Bar Association, PLI, Executive Enterprises, Garrett Law Institute (Northwestern University), Tulane Corporate Law Institute, and Tennessee Law Institute.

Education
• University of Illinois, BS in Accounting

PATRICK MCGURN
SPECIAL COUNSEL
RiskMetrics Group

Patrick McGurn provides special counsel to RiskMetrics Group's ISS Governance Services unit. Considered by industry constituents to be one of the leading experts on corporate governance issues, he is active on the nationwide speaking circuit and plays an integral role in policy development.

Prior to joining RiskMetrics Group, McGurn was director of the Corporate Governance Service at the Investor Responsibility Research Center (IRRC), a not-for-profit firm that provides governance research to investors. He also served as a private attorney, a congressional staff member and a department head at the Republican National Committee.

McGurn is frequently cited by business publications such as *The Wall Street Journal* and *BusinessWeek*. He has appeared on *ABC World News Tonight*, *Bloomberg Radio* and *TV*, *BBC Radio*, *CBS Evening News*, *CNBC*, *CNN*, *Marketplace, NBC Nightly News, Nightly Business Report, National Public Radio*, *Tech TV* and ABC's *This Week*.

McGurn is a graduate of Duke University and the Georgetown University Law Center. He is a member of the bar in California, the District of Columbia, Maryland and the U.S. Virgin Islands.

He serves on the Advisory Board of the *National Association of Corporate Directors* and was a member of the NACD's 2001 Blue Ribbon Commission on Board Evaluations.

JAY O. ROTHMAN
PARTNER
Foley & Lardner LLP

Jay O. Rothman is a partner and a member of Foley & Lardner's Management Committee. Mr. Rothman serves as the chair of the firm's national Transactional & Securities Practice and practices primarily in the areas of mergers and acquisitions, securities law, takeover defense, and general corporate and business law. Among other transactions, he has structured and negotiated numerous acquisition transactions in various industries and has represented both underwriters and corporate issuers in various public offerings of both debt and equity securities. Mr. Rothman also regularly counsels publicly held companies regarding compliance matters under federal and state securities laws. He is also a member of the firm's Energy Industry Team.

Mr. Rothman was among 113 attorneys nationwide who made The BTI Consulting Group's coveted Client Services All Star Team for 2007 and one of only five attorneys recognized as a "Super All-Star" for being nominated by more than one client. This honor is bestowed upon individual attorneys who deliver outstanding client service according to corporate counsel interviewed at Fortune 1000 companies. Mr. Rothman was named to the Client Service All Star Team in 2005 as well. In addition, Mr. Rothman is listed in *The Best Lawyers in America®* (2005-08) and *Chambers USA: America's Leading Business Lawyers* (2005-07). He was also named to the 2006 list of Wisconsin Super Lawyers by *Law & Politics Media, Inc.* for his securities and corporate finance work.

Prior to joining Foley in 1986, Mr. Rothman served as a law clerk to the Hon. Harlington Wood, Jr., United States Court of Appeals for the Seventh Circuit. He graduated, *cum laude*, from Harvard Law School in 1985. He received his B.A., *summa cum laude*, from Marquette University in 1982, where he was elected to membership in Phi Beta Kappa.

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Executive Compensation Updates

Jay O. Rothman
Joshua A. Agen
February 21, 2008

1. SEC Disclosure Rules Update

a. Rules and Recent Guidance: In 2006, the SEC adopted major revisions to its disclosure requirements for executive and director compensation. After companies filed the first round of proxy statements under the new rules in early 2007, the SEC reviewed and issued comment letters with respect to the disclosure under the new rules of 350 large public companies. The SEC also issued a report summarizing the themes emerging from its review and comment process. The SEC has recently started to make publicly available company responses to its comment letters. As companies prepare their 2008 proxy statements, these responses from companies that the SEC staff has cleared are a potential source of guidance on what sort of disclosure the SEC views as responsive to the new rules.

b. CD&A: In its comment letters and report, the SEC focused primarily on the new "Compensation Discussion & Analysis" section, or "CD&A." The SEC intends the CD&A to be a comprehensive discussion of the key factors underlying compensation policies and decisions relating to a company's top executives. The SEC's comment letters and report indicated that companies generally needed to improve both the substance of the disclosure and the manner of presentation. The SEC indicated that the CD&A should focus on "how" and "why" companies arrive at specific decisions and policies regarding executive compensation rather than merely describing processes and amounts. The SEC also reiterated the importance of plain English principles and urged companies to replace boilerplate and complex, technical language with more specific analysis presented in a simple way.

c. Performance Targets: The new rules require that companies disclose corporate and individual performance targets if the targets are a material element of the company's compensation policies and decisions, unless disclosure would result in competitive harm. The SEC issued more comments on performance target disclosure than any other disclosure topic. Where performance targets appeared material but were not disclosed, the SEC asked companies to include the targets or demonstrate that disclosure of the targets could cause competitive harm. Where companies omitted targets on the basis that including them would cause competitive harm, the SEC frequently asked for more specific disclosure of the difficulty or likelihood of attaining target level performance. According to a recent poll by Watson Wyatt Worldwide, however, a significant number of large U.S. companies do not plan to disclose performance goals in their 2008 proxy statements.[1] The poll, which included legal, compensation and HR executives

[1] See "Many Companies Still Unlikely to Disclose Performance Goals in Their 2008 Proxy Statement, Watson Wyatt Poll Finds," available at http://www.watsonwyatt.com/us/news/press.asp?ID=18567.

at 135 large, publicly traded companies, indicated that 42% of companies plan to disclose specific performance goals; 31% of the companies do not plan to disclose such goals; and 27% were undecided.

d. Related Person Disclosure: The new rules also require disclosure of a company's policies and procedures for reviewing related person transactions and any related person transactions that are not subject to review under the policies and procedures. In addition, the new rules would require disclosure of compensation paid to executive officers who are not required to be covered in the CD&A or executive compensation tables as a related person transaction unless, among other requirements, such compensation is approved by the compensation committee or is below the dollar threshold for such disclosure. In light of this change, all executive officer compensation should be considered and approved (or recommended for board approval) by the compensation committee.

2. Section 162(m) of the Internal Revenue Code

a. Overview: Section 162(m) of the Internal Revenue Code limits the deductibility of compensation paid to a public company's CEO (and each of the company's other three most highly compensated employees excluding the CFO) to $1 million per year, plus the amount of any performance-based compensation.

b. Change in Covered Employees: Prior to July of 2007, the IRS had interpreted Section 162(m) to cover compensation paid to a company's CEO and each of the company's other four most highly compensated employees, mirroring the group of employees included in the SEC's old proxy disclosure rules. In response to the change in the group of employees for whom disclosure is required under the new disclosure rules, the IRS issued Notice 2007-49, modifying its interpretation of Section 162(m) to cover compensation paid only to a company's CEO and each of the company's three other most highly compensated employees, but not compensation paid to the individual serving as the "principal financial officer" within the meaning of the new disclosure rules.

c. Performance-Based Compensation: Earlier this year, the IRS released a revenue ruling and made public a private letter indicating a reversal of its position on an interpretation concerning the effect of severance arrangements on "performance-based compensation."

i. In general, to qualify as performance-based compensation, the following conditions must be satisfied.

(1) Goals must be designated by a compensation committee composed entirely of two or more "outside" directors as defined by the Internal Revenue Code and related regulations.

(2) A description of the performance criteria used to establish the goals must be approved by a majority of the company's shareholders prior to any compensation payments based on achievement of such goals.

(3) Compensation must be conditioned on the achievement of pre-established, objective performance goals, and achievement of the goals must be certified by the compensation committee prior to payment of the compensation.

Performance-based compensation includes most options, but does not include restricted stock or other full value shares unless the grant or vesting is tied to pre-established objective performance goals. An option is not performance-based if it is granted at less than fair value or if it is protected from decreases in the company's share price (such as through the use of automatic repricing).

ii. IRS regulations provide that compensation payable at a guaranteed level on death, disability or a change of control does not disqualify an arrangement as performance-based compensation if the other requirements are met. In private letter rulings in 1999 and 2006, the IRS had taken the position that compensation payable at a guaranteed level on an involuntary termination without cause, a voluntary termination for good reason or retirement would receive the same treatment. The IRS's recent revenue ruling and private letter ruling reversed this position with respect to involuntary terminations without cause, voluntary terminations and retirements. This reversal raises an array of interpretive and compliance questions that the IRS has yet to fully address, and many companies are likely to be affected. Companies should examine their employment arrangements with executives potentially subject to Section 162(m) to determine whether they are implicated by this change. In its revenue ruling, the IRS provided transition relief that will exempt otherwise Section 162(m)-complaint compensation arrangements from the IRS's new position (1) that were in existence on February 21, 2008 or (2) for performance periods commencing on or before January 1, 2009.

3. IRC Section 409A

a. Overview: Beginning in 2005, Section 409A of the Internal Revenue Code created an entirely new tax regime with respect to the structure and timing of deferred compensation arrangements, as well as significant new penalties for violations of the rules.

b. Timing. Final regulations were issued in April 2007 with an original compliance deadline of December 31, 2007, but, in the fall of 2007 the IRS extended the required compliance deadline for documentary compliance to December 31, 2008 and the effective date of the final regulations to January 1, 2009. Despite these extensions, existing arrangements must be administered in good faith compliance with the Section 409A through the end of 2008. Nearly every company that has deferred compensation arrangements will need to amend these arrangements in light of Section 409A prior to December 31, 2008, if they have not already done so. Failure to address Section 409A issues on a timely basis could result in employees, directors and some independent contractors having to pay significant additional taxes and penalties that could easily be avoided.

c. Types of Arrangements Subject to New Rules: Section 409A applies to "deferred compensation plans," defined broadly to include any situation in which a service provider has a legally binding right during a taxable year to compensation that is payable in a later taxable year. Thus, traditional voluntary deferred compensation plans, stock options and stock appreciation rights not meeting Section 409A's requirements for exemption, supplemental retirement and other excess benefit plans, bonus plans and severance and earn-out arrangements may be subject to Section 409A.

d. Types of Arrangements Excluded from New Rules: Section 409A does not apply to qualified retirement plans and certain welfare benefit plans, including bona fide vacation leave, sick leave, compensatory time, disability pay or death benefit plans under which benefits are not currently taxable.

e. Basic Requirements: Under Section 409A, a purported deferral of compensation will not be respected for tax purposes unless the deferred compensation plan under which the deferral is made satisfies the requirements of Section 409A in both form and operation. Some requirements include:

i. The initial deferral election must be irrevocable and made prior to the year in which the services giving rise to the deferred compensation are performed.

ii. In certain circumstances, if a covered individual first becomes eligible to participate in a deferred compensation plan during a tax year, the election may be made within 30 days of initial eligibility.

iii. If the compensation is payable under a performance-based compensation plan with a performance period of at least 12 months, the deferral election may be made at any time that is at least six months prior to the end of the performance period, subject to certain other technical requirements.

iv. Payments of deferred compensation may only be made upon the occurrence of specified events listed in Section 409A, including separation from service (subject to a six month delay for certain key employees of public companies), death, disability and a change of control.

v. A covered individual's ability to change the timing and form of distribution is restricted.

f. Consequences of Violations: If the terms of a deferred compensation plan do not comply with Section 409A or if the plan is not operated in compliance with Section 409A, in addition to the purported deferral not being effective and the executive being taxed on the amount of the deferral, the executive would be required to pay an additional tax equal to 20 percent of the compensation and to pay interest at the underpayment rate plus one percent from the initial deferral date (or if later, the date the deferral amount became vested).

g. Transition Rule on Changes to Deferral Elections: Until December 31, 2008, a temporary transition rule allows employees to change their elections with respect to the time and form of payment (so long as the change would not accelerate amounts otherwise payable after 2008 into 2008 or defer amounts otherwise payable in 2008 until after 2008).

4. The Role of the Compensation Committee in Setting Compensation

a. General: One of the responsibilities of the typical compensation committee is to ensure that the company's CEO (among other corporate officers) is compensated competitively and effectively in a manner consistent with the company's overall strategic plan and in furtherance of the long-term interests of shareholders. A primary objective of the compensation committee is to provide a compensation package capable of attracting, retaining and motivating strong leaders and managers. The compensation committee may also be responsible for setting board compensation.

b. Linking Compensation to the Achievement of Company Goals: Compensation committees continue to play an increasingly expansive role in shaping and, more importantly, implementing a company's strategic plan as more companies seek, and shareholders expect companies, to link compensation directly to the achievement of the corporate objectives set forth in their respective strategic plans.

i. Companies may want to consider linking a portion of compensation to alternative performance measures in addition to earnings and stock performance. Companies should consider financial and non-financial performance measures that address particular aspects of corporate strategy (*e.g.*, economic profit, product quality, etc.). For a further discussion of this topic, see Section 6 of this outline.

ii. Compensation committees should be mindful that institutional and individual shareholders are increasingly challenging compensation deemed to be "excessive" through actual and threatened proxy contests, shareholder proposals included in the company's proxy materials and litigation. In addition, the SEC has been focusing on executive compensation matters through enforcement actions. The SEC has also broadened the scope of compensation disclosures in its new executive disclosure regulations.

c. Fiduciary Obligations of the Compensation Committee

i. General: Members of the compensation committee have fiduciary obligations comparable to directors generally, including the duties of care and loyalty. Compensation decisions that are made in good faith and on a fully informed basis by a committee of independent directors are generally afforded the protection of the business judgment rule. Recent court cases have addressed the scope of a compensation committee's and board of director's fiduciary duties in the context of executive compensation as discussed in Section 10(d) of this outline.

ii. Minimizing Liability of Compensation Committee Members

(1) Independence of Committee Members: Boards should ensure that compensation committee members are truly independent to avoid the damaging disclosure of director and executive interrelationships seen in recent lawsuits. The use of heightened independence standards, in addition to the applicable listing standards, may be warranted in certain situations. The amounts of compensation received by directors must also be examined.

(2) Limit Input from Executive Officers: Input from an executive officer for whom the compensation committee is setting compensation should be limited or eliminated. Doing so not only further demonstrates the independence of the compensation committee, but also avoids disclosure relating to the executive's role required by the new disclosure rules.

(3) Committee Meeting Procedures: The compensation committee should develop and update a list of priorities and a meeting timetable for each year. Compensation committee meetings should be scheduled to coincide with the company's performance calendar (*e.g.*, earnings announcements and annual shareholders' meetings) and compensation calendar (*e.g.*, annual review of executives' compensation, annual equity award granting date, etc.). Materials should be provided to compensation committee members in *advance* of the meeting to allow adequate preparation. Finally, compensation committee meetings should be conducted in a manner that ensures open communication, meaningful participation and timely resolution of issues.

(4) Maintain Accurate Minutes: Ensure that compensation committee minutes are sufficiently detailed to show that directors have satisfied their duty of care obligations. Among other things, the minutes should describe each item acted upon by the compensation committee. The minutes should include analyses as to the costs to the company of the compensation or severance arrangements at issue and document the use of counsel and compensation consultants. The minutes should also include a summary of the factors that the compensation committee considered in making a decision and any alternative actions considered.

(5) Ensure Complete Proxy Disclosure: Ensure accurate disclosure in the proxy statement that provides the investor with full disclosure regarding executive compensation and the processes that the compensation committee utilized to determine compensation levels.

(6) Use Outside Advisors: The compensation committee, not management, should hire a compensation consultant and utilize the consultant to help it analyze proposed pay packages. The compensation committee should urge the consultant to evaluate the compensation packages thoroughly and make recommendations without fear of reprisal (*e.g.*, termination). The compensation committee should also consult with counsel as appropriate regarding legal matters in connection with negotiating compensation and severance arrangements. For a further discussion of the use of outside advisors, see Section 5 of this outline.

(7) Avoid Over-Reliance on Benchmarks and Surveys: Compensation surveys can be misleading and biased as peer group companies can be hand selected to achieve the desired result. The practice of benchmarking executive compensation within a percentile of that paid by other companies can result in exponential growth in compensation.

(8) Carefully Evaluate Each Component of Compensation: The compensation committee should individually evaluate and understand the potential magnitude of each component of a proposed compensation or severance package and, if required, seek the assistance of a specialist to evaluate individual components. The compensation committee should ensure that it understands all costs to the company in connection with such compensation and severance arrangements. Accurate evaluation is essential to meaningful and adequate shareholder disclosure. The amounts related to deferred compensation, supplemental executive retirement plans (SERPs), perquisites and severance and termination payments may be of particular interest. The compensation committee should carefully review and consider whether past compensation practices need to be revisited in light of current trends in executive compensation. The compensation committee may wish to consider use of tools such as tally sheets and internal pay equity and wealth accumulation analyses.

d. Approval of All Executive Officer Compensation. The compensation committee should approve the compensation of all executive officers, not just the compensation of those executive officers whose compensation is reported in the proxy statement, to avoid having to disclose such compensation as a related person transaction.

5. The Use of Outside Counsel and Consultants

a. In fulfilling their fiduciary obligations, compensation committee members are allowed to rely on the advice of outside advisors (*e.g.*, outside counsel and compensation consultants).

b. Some institutional investors are emphasizing the need for outside counsel and compensation consultants to provide advice and guidance.

c. External compensation consultants may be used for periodic reviews of committee procedures and compensation plans.

i. The NYSE corporate governance rules state that the compensation committee should have sole authority to retain and terminate the consulting firm, including sole authority to approve the firm's fees and other retention terms.

ii. External consultants can provide guidance to compensation committee members on the general compensation marketplace and complex compensation techniques.

iii. The use of outside advisors assists in achieving a broader perspective on the competitive environment and in developing benchmarking against peer performance.

iv. Outside advisors may assist in the development of highly specialized plans for significant developments, including changes in control, acquisitions and divestitures.

d. The compensation committee also should consider employing an outside party skilled in employment contracts to review and negotiate employment and severance agreements with the company's CEO (and other officers).

6. Pay for Performance Issues

a. Renewed Emphasis: Performance-based compensation is an increasingly popular topic among compensation committees, shareholders and compensation consultants.

i. Possible Future Best Practices:

(1) Target Base Compensation: Move to the median levels while allowing strong performance to drive total compensation higher.

(2) Indexing: Some commentators have suggested indexing performance targets. For example, the compensation committee would set a performance target of 2% more growth in revenues than the company's competitors. The benefit of indexing is that a company's officers (including the CEO) are not unjustly punished in a bear market if the company performs better than its competitors (though maybe not as well as the prior year) and a company's officers (including the CEO) are not unjustly enriched in a bull market if the company performs less well than its competitors.

(3) Payout Levels: Sensitivity of payouts at various levels (target, maximum, threshold).

(4) External Data: Use of the same peer group for pay and performance measures and use of market data to validate both pay and performance.

(5) Total Compensation: Increased focus on the total package including salary, cash bonus arrangements, equity, and other benefits (SERPs, deferred compensation, etc.).

ii. Performance Goal Setting: Increased desire for a move into performance based units and performance shares.

iii. Performance Stock/Units: Many commentators view performance stock/units as preferable to time-based restricted stock.

7. Equity-Based Compensation

a. Equity Awards

i. General: Stock options have historically been a popular form of equity-based compensation. Companies originally granted stock options because of what was then viewed as a cost-free way to align the interests of management with that of shareholders. However, the reliance on stock options as a method of compensation has decreased in recent years.

ii. Disadvantages of Stock Options:

(1) Stock options could encourage behavior that focuses on short-term increases in stock price instead of long-term value because stock options often do not mandate a minimum holding period after exercise.

(2) Executives can profit from stock options in a bull market regardless of their own individual performance.

(3) Stock options are subject to expensing pursuant to FASB Statement No. 123(R).

(4) There is a perception, supported by the over 150 companies found to have backdated options, that the granting of stock options can easily be manipulated to the benefit of insiders.

iii. Trends Related to Equity Based Awards: Companies are de-emphasizing the role of stock options. Although most are not replacing stock options completely, more are using a mix of different types of equity compensation. According to a recent study by Frederic W. Cook & Co. of the 250 largest companies in the S&P 500, 82 percent of the companies reviewed used stock options, which was down from 95 percent three years earlier.[2] However, over the same three-year period, the use of restricted stock has increased from 55 percent to 73 percent of the largest 250 companies in the S&P 500. Additionally, use of performance shares saw an increase to 50 percent from 30 percent three years earlier for the same group of companies. One reason for the shift from a reliance on stock options to increased use of restricted stock and performance shares is the current dissatisfaction of the public, press and institutional investors with stock options, caused in part by the stock option backdating scandals.

iv. Performance-Vested Options: Commentators have recommended that companies consider the use of performance-vested options.

(1) Typical provisions of performance-vested options include the following:

(a) Price appreciation to be earned for achieving specified goals.

(b) Retention for one year or more after exercise.

(2) Advantages of performance-vested options include the following:

(a) Limited potential dilution from outstanding grants because grants that do not vest would go back into the pool for new grants.

(b) Truly performance-oriented because either the goals are achieved or the option value is forfeited.

(c) Would limit short-term flipping and add long-term incentive and risk.

b. Equity Compensation Plans

i. Shareholder Approval: Equity compensation plans generally must be approved by shareholders.

ii. Guidelines: Commentators have suggested the following guidelines to ensure that shareholder-approved equity compensation plans provide for maximum flexibility:

(1) Include employees and outside directors in one plan.

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[2] See "The 2007 Top 250: Long-Term Incentive Grant Practices for Executives," available at http://www.fwcook.com/alert_letters/2007_Top_250.pdf.

(2) Include all equity types in the plan (plus cash awards).

(3) Do not include vesting provisions in the plan; rather incorporate in the award agreement.

(4) Do not include change of control provisions in the plan; rather incorporate in the award agreement.

(5) Include shares on a "net as issued" basis (not as granted).

(6) Include terms of third party option transferability in the future.

8. **Stock Ownership Requirements.** More companies are adopting stock ownership and stock retention policies for their CEOs, other executives and directors. According to a study by Frederic W. Cook & Co. of the 250 largest companies in the S&P 500, 83 percent disclosed stock ownership guidelines for executives in 2007, representing an increase from 57 percent in 2004.[3] Most companies set the required level of stock ownership as a multiple of the executive's compensation.

9. Rule 144/Restricted Securities Amendment

a. Background. Rule 144 establishes a non-exclusive safe harbor that permits the public resale of privately placed securities, known as "restricted securities," and securities held by affiliates of an issuer, known as "control securities," without registration pursuant to Section 4(1) of the Securities Act of 1933. In 2007, the SEC amended Rule 144 to liberalize the requirements for application of the safe harbor in some respects; these changes became effective on February 15, 2008. For an in depth discussion of these amendments, see the attached Foley & Lardner LLP Legal News Update dated January 2, 2008.

b. Holding Period Shortened. Rule 144 requires that a security holder hold restricted securities for a long enough period of time to demonstrate that he or she assumed the economic risk associated with the securities. For restricted securities of issuers subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the amendments to Rule 144 shorten the required holding period from one year to six months. The holding period for securities of issuers not subject to Exchange Act reporting requirements continues to be one year. These holding periods are the same for both affiliates and non-affiliates of the issuer. After the holding period is satisfied, non-affiliates may freely sell the securities, while affiliates must continue generally to meet the other requirements of Rule 144.

c. Filing Requirements Liberalized. Non-affiliates will no longer be required to file Form 144 upon a resale of restricted securities. Affiliates must continue to report resales on

[3] See "The 2007 Top 250: Long-Term Incentive Grant Practices for Executives," available at http://www.fwcook.com/alert_letters/2007_Top_250.pdf.

Form 144, but only if they exceed 5,000 shares or $50,000 within a three-month period. Previously, the thresholds were 500 shares or $10,000.

d. Manner of Sale Requirements Relaxed for Affiliates. The SEC adopted two changes to the manner of sale requirements applicable to affiliates. First, the Rule 144 amendments permit the resale of securities through principal transactions without risk. Second, the amendment redefines the term "brokers' transactions" to allow brokers to insert bid and ask quotations for a restricted security in an alternative trading system, if the broker has published bona fide bid and ask quotations for that security in the alternative trading system on each of the l2 preceding business days.

e. Affiliates Can More Easily Resell Debt Securities. The manner of sale requirements no longer apply to resales of debt securities by affiliates. The Rule 144 volume limitations, moreover, have been amended to permit the resale of debt securities in an amount not exceeding 10% of a tranche, together with all sales of securities of the same tranche sold for the account of the selling security holder within a three-month period.

10. Executive Compensation Remains a Top Priority

a. Shareholder Activism:

i. Shareholder proposals and other initiatives aimed at limiting executive compensation, options backdating, pay for superior performance, severance payments, golden parachutes and stock option repricing are expected to increase. Labor funds have traditionally submitted the majority of shareholder proposals related to executive compensation and are expected to do so again this year.

ii. Shareholder proposals seeking to give shareholders an advisory vote on executive compensation packages – so-called "say on pay" measures – are expected to be more common in 2008. In January 2008, a group of institutional investors announced that it had filed shareholder resolutions at over 90 U.S. companies.[4] In 2007, there were more than 40 shareholder resolutions seeking an advisory vote on compensation, which garnered an average of 42 percent support.[5] Verizon, Par Pharmaceutical and Aflac have adopted policies for advisory shareholder votes on company executive compensation practices. Aflac's first vote, originally scheduled for 2009, has been moved up to 2008. In response to shareholder approval of an advisory vote proposal in 2007, Ingersoll-Rand Co. plans to hold meetings with its 25 largest shareholders in the third quarter of each

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[4] See "Institutional Investors Continue to Press Companies for an Advisory Vote on Executive Pay," available at http://www.afscme.org/press/17494.cfm.

[5] See Peter Moon, et al., "Global Investors Laud Shareholder Votes on Executive Compensation," available at http://www.compensationstandards.com/member/misc/02_05_08_Moon.pdf.

year to review governance matters and to provide an email address for the company's compensation committee chair.

iii. Pay for superior performance proposals have also been common. Such proposals, filed by labor funds at more than 50 companies in 2007, broadly call for companies' compensation committees to establish a pay-for-superior-performance standard in executive compensation plans. Under the proposals, annual incentives or bonuses would use defined financial performance criteria benchmarked against a disclosed peer group of companies, and no bonus would be paid unless the company's performance exceeds its peers' median or mean performance on the selected financial criteria.

iv. A new shareholder proposal in 2008 calls on boards to adopt principles restricting use of so-called "Rule 10b5-1" plans. Rule 10b5-1 plans generally allow insiders to buy and sell company shares without incurring liability for insider trading if their trades are based on a plan established with an independent broker when the insider was not in possession of material non-public information. Recently, in light of evidence suggesting that Rule 10b5-1 plans may be strategically implemented to enhance returns, such plans have come under scrutiny by the SEC and others for potential abusive practices. The shareholder proposal on Rule 10b5-1 plans calls for a 90-day gap between adoption or amendment of such plans and initial trading under the plans, a prohibition on executives' trading in company stock outside of the plans and a requirement to identify plan transactions in Section 16 filings.

b. **SEC Action:** The SEC is using its new enforcement powers under the Sarbanes-Oxley Act to force the disgorgement of executive compensation due to, among other things, misleading disclosure and fraud.

c. **IRS Action:** The IRS is continuing to conduct regular Section 162(m) audits with respect to the administration of bonus plans.

d. **Litigation/Enforcement Actions:** As evidenced by a number of recent, well-publicized proceedings, investors and regulators have become more aggressive in their attempts to hold boards of directors liable for questionable compensation practices and curtail excessive executive compensation.

i. **Options Backdating:** Delaware courts issued several opinions in 2007 addressing whether lawsuits can proceed that seek to hold directors liable for option backdating as well as for "spring-loaded" and "bullet-dodging" option grants.

(1) Two decisions issued in February 2007 denied directors' motions to dismiss the complaints as a matter of law, which required the court to assume the plaintiff's factual allegations as true. A subsequent decision in June 2007 granted directors' motions to dismiss. All three cases were derivative complaints, which generally require the plaintiff to make a demand on the board of directors to remedy the alleged misconduct and decide whether to proceed with a lawsuit. However, the "demand" requirement is excused when there is a reason to question whether the challenged transactions involved a valid exercise of business judgment or that a majority of the directors would have been independent and disinterested when considering the demand.

(2) In one of the February cases (*Ryan v. Gifford*), the plaintiff alleged a breach of fiduciary duties by the board in approving backdated options that violated shareholder approved stock option plans. Relying solely on empirical data indicating that the low stock prices on option grant dates were unlikely to be the result of chance, the complaint alleged nine occasions where the CEO was awarded backdated options. The court excused the plaintiff from having to satisfy the demand requirement and found the factual allegations sufficient to support a claim that the directors' actions were intentional and a violation of the duty of loyalty.

(3) In the other February case (*In re Tyson Foods*), the plaintiff alleged the board of directors of Tyson Foods granted "spring loaded" options to insiders. Spring-loaded options are granted prior to the release of material information that is likely to send the stock price higher. The court held that a director who intentionally uses inside information to enrich employees in violation of shareholder-approved stock option plans breaches his fiduciary duties of good faith and loyalty. However, the court noted that the spring-loaded claim was only properly alleged against members of the compensation committee who approved the grants, not the whole board.

(4) It is important to note that in both February cases, because of their early stage, the opinions did not address the extent to which directors' reliance on the advice from officers or other experts in granting options may be a defense to liability. Additionally, the court held that directors could not rely on the statute of limitations as a defense because the failure to comply with the shareholder approved plans had been concealed from shareholders in a fraudulent manner.

(5) These two February opinions are important because they establish that intentional stock option backdating and spring-loading, if proven, are violations of a director's duty of loyalty, for which limited liability statutory defenses would be unavailable. Therefore, such claims leave the director open to liability for monetary damages.

(6) In June 2007, the Delaware Court of Chancery issued a decision (*Sycamore Networks*) dismissing a derivative lawsuit based on spring-loading and bullet-dodging, suggesting that claims based on spring-loading and bullet-dodging may not survive a motion to dismiss without sufficiently pleading both substantive wrongdoing and individual participation with particularity. In a possible contrast to the two February cases, the court in Sycamore Networks required the plaintiff to demonstrate demand futility by pleading facts giving rise to the inference that compensation committee members faced a substantial of likelihood of personal liability through knowing wrongdoing or involvement in the mechanics by which options were issued, or the dates on which the relevant administrative tasks were carried out. The court dismissed the plaintiff's allegations of spring-loading, stating that "if directors consciously granted options in advance of the issuance of positive information as a bonus, disclosed their motivations candidly, and accounted for the options in good faith reliance on experts, it is difficult to perceive the existence of a fiduciary duty claim other than for excess compensation." Similarly, with respect to bullet-dodging, the court was skeptical that "a bare allegation that a board of directors made a discretionary issuance of stock options at the market stock price after releasing negative information can ever be sufficient in itself to state a claim of director disloyalty, even when a stockholder-approved option plan requires fair-market-value grants."

ii. Disney conclusion: The stockholder derivative suit filed in 1997 relating to the hiring and subsequent firing of Michael Ovitz as the President of Disney has concluded.

(1) By way of review, the suit alleged that, although the compensation committee unconditionally approved the general terms of Mr. Ovitz's employment agreement, the compensation committee, among other things, (a) did not receive a copy of the draft employment agreement, (b) did not question or receive any information comparing the draft agreement to similar agreements in the industry, (c) did not receive any calculations showing the likely costs of the agreement, (d) did not consult with a compensation expert, (e) was not told the exercise price of the options to purchase five million shares that Mr. Ovitz was to receive, and (f) spent most of the hour-long meeting discussing the $250,000 payment a member of the committee was to receive for securing Mr. Ovitz's employment.

(2) Disney's full board met immediately after the compensation committee meeting and the suit alleged that the members of the board breached their fiduciary duties "when they blindly approved an employment agreement" with Mr. Ovitz. In particular, the plaintiffs alleged that the board (a) did not receive any documents relating to Mr. Ovitz's agreement prior to the meeting, (b) did not receive guidance from a compensation expert, (c) did not receive a report from the compensation committee, (d) did not question the details of the agreement, and (e) did not seek any additional information regarding Mr. Ovitz's hiring. Nonetheless, the full board appointed Mr. Ovitz President of Disney at the meeting, leaving final negotiation of the employment agreement to Michael Eisner, Disney's CEO.

(3) The plaintiffs alleged that the total value of the severance package Disney paid to Mr. Ovitz for approximately 15 months of work was valued at $140 million.

(4) After a lengthy trial, the Delaware Court of Chancery in August 2005 held that the Board was not liable for a breach of its fiduciary duty or for corporate waste.

(a) The Court strongly criticized the Board's actions and found that it fell "significantly short" of corporate governance best practices.

(b) The Court also found, however, that the directors had not acted in bad faith in the hiring and subsequent termination of Mr. Ovitz. At most, the Court found the directors had been "ordinarily negligent" in approving Mr. Ovitz's employment agreement. In affirming the business judgment rule, the Court held that "ordinary negligence is insufficient to constitute a violation of the fiduciary duty of due care."

(c) As to the termination of Mr. Ovitz, the Court found that, because Mr. Eisner as CEO had the authority to fire Mr. Ovitz without board approval, the board's inaction did not violate its fiduciary duty. Again relying on the business judgment rule, the Court found that plaintiffs had not shown that Mr. Eisner acted in bad faith or violated his fiduciary duty of care because he had considered various options for removing Mr. Ovitz and had sought advice from counsel before settling on a course of action.

(d) Finally, the Court found that Mr. Ovitz did not breach his fiduciary duty of loyalty because he was not acting as a fiduciary when negotiating his employment agreement and had no role in the decision to terminate Mr. Ovitz without cause. The Court, citing testimony that Disney would be better off without Mr. Ovitz, also found that his termination and the payment of the severance package did not constitute waste.

(e) The shareholders appealed, but on June 8, 2006 the Delaware Supreme Court delivered its long-awaited opinion, which affirmed the Chancery Court's decision. The Delaware Supreme Court clearly affirmed the business judgment rule and rejected the notion that lack of good faith can be equated with gross negligence.

e. **Federal Government Action:** With the significant negative press surrounding large severance packages received by former CEOs Charles Prince (Citigroup), Stanley O'Neal (Merrill Lynch) and Bob Nardelli (Home Depot) and the Democratic control of Congress, there have been indications the federal government may attempt to curtail what it perceives as excessive executive compensation.

i. **Senate:** Sen. Carl Levin (D-Mich.) recently introduced a bill that would seek to modify the tax treatment of stock options. The bill would, among other things, match the corporate tax deduction for stock option compensation to the book expense reflected in a company's financial statements; permit companies to deduct stock option compensation in the same year that it is recorded on their books, rather than when the options are exercised; and make stock option compensation subject to the $1 million cap on the deductible compensation under Section 162(m).

ii. House of Representatives:

(1) "Say on pay" legislation introduced by long-time critic of executive compensation largesse Rep. Barney Frank (D-Mass.) was passed by the House of Representatives in April 2007. The Senate has not yet taken action on the legislation.

(2) Rep. Henry Waxman (D-Cal.), the Chairman of the House Committee on Oversight and Government Reform, has asked Prince and O'Neal as well as retiring CEO of Countrywide Financial Angelo Mozilo to testify at a February 28, 2008 hearing on severance pay. In December 2007, Waxman convened a hearing on the topic of compensation consultant conflicts of interest and released a report, based on requests for information previously sent to six prominent compensation consultant firms, concluding that "compensation consultant conflicts of interests are widespread."[6] In January 2008, Waxman sent letters to the compensation committees chairs of each of the Fortune 250 companies seeking additional information concerning potential conflicts.

iii. Executive: President Bush has expressed the view that salaries and bonuses of CEOs should be based on their success at improving their companies and bringing value to shareholders and, without advocating for government intervention on setting salary levels, extolled boards to pay attention to pay packages they approve. Although the current White House is not expected to take additional action on executive compensation, this topic may become an issue in the 2008 presidential campaign.

11. Setting Board Compensation

a. Amount of Board Compensation

i. According to a 2007 Institutional Shareholder Services study, director compensation is up 12%, to approximately $160,000 per year. This study attributed most of the increase to increased equity value.

ii. Although the combination of an annual retainer and per meeting fees is the most common compensation package for directors, there is currently a debate in the business community regarding whether directors should receive per meeting fees at all.

[6] See United States House of Representatives Committee on Oversight and Government Reform Majority Staff, "Executive Pay: Conflicts of Interest Among Compensation Consultants" (December 2007).

Eliminating per meeting fees and instead adopting "full-service" annual retainers can have the following advantages:

(1) it eliminates the perception of being "paid to show up;"

(2) it can simplify administrative matters by, for example, eliminating questions about what constitutes a meeting (such as telephonic attendance) or whether the length of the meeting should affect the per meeting fee amount; and

(3) it helps make the director compensation program more transparent.

b. Stock Ownership Requirements: More companies are also adopting stock ownership and stock retention policies for their directors.

i. Ownership: According to a January 2007 Institutional Shareholder Services study, fifty-six percent of S&P 500 companies had implemented stock ownership guidelines for non-employee directors.

ii. Retention: Instituting holding requirements for directors is a relatively recent phenomenon. There is a debate regarding whether a fixed period of time, such as a year, is a sufficient holding period, or whether board members should be required to hold their shares until they are no longer serving on the board (and possibly even for some period of time after leaving the board).

c. Proxy Disclosure of Director Compensation: The revisions to SEC disclosure rules have substantially increased the detail required in the reporting of directors' compensation in proxy statements.

Legal News is part of our ongoing commitment to providing legal insight to our Transactional & Securities industry clients and colleagues.

If you have any questions about this newsletter or would like to discuss this topic further, please contact your Foley attorney in the following offices:

Boston
617.342.4000

Century City
310.277.2223

Chicago
312.832.4500

Detroit
313.234.7100

Jacksonville
904.359.2000

Los Angeles
213.972.4500

Madison
608.257.5035

Miami
305.482.8400

Milwaukee
414.271.2400

New York
212.682.7474

Orlando
407.423.7656

Sacramento
916.443.8005

San Diego
619.234.6655

San Francisco
415.434.4484

Silicon Valley
650.856.3700

Tallahassee
850.222.6100

Tampa
813.229.2300

Washington, D.C.
202.672.5300

SEC Eases Restrictions on Resale of Restricted Securities

On December 7, 2007, the U.S. Securities and Exchange Commission (SEC) issued final rules amending existing Rules 144 and 145 under the Securities Act of 1933 (Securities Act).[1] The revisions are intended to increase the liquidity of privately sold, restricted securities and decrease issuers' cost of raising capital. Rule 144 provides a non-exclusive safe harbor that permits investors to resell restricted securities without registration pursuant to the exemption under Section 4(1) of the Securities Act. The amendments reduce the holding period required before restricted securities may be sold, liberalize the manner of sale and volume limitations, simplify the Form 144 filing requirements, and codify certain SEC staff interpretations relating to Rule 144. The final rules further eliminate the "presumptive underwriter" doctrine under Rule 145. The revised rules take effect on February 15, 2008.

Implications of the Amendments

The amendments to Rule 144 and Rule 145 allow issuers to negotiate a smaller discount to market price when selling unregistered securities in an exempt offering such as a Regulation D offering. Furthermore, because of the shortened holding period, registration rights may be unnecessary for issuers negotiating a private placement. Issuers currently required to maintain effective resale registration statements may be able to terminate those registration statements earlier than anticipated, given that holders of restricted securities may be able to sell those securities more quickly. Finally, in business combination transactions, restricted securities may be more favorably received as consideration due to their increased liquidity.

Overview of Rule 144

The Securities Act requires the registration of all offers and sales of securities made in interstate commerce or by U.S. mail unless a statutory exemption is available for the transaction. Section 4(1) of the Securities Act provides an exemption for transactions by a person who is not an issuer, underwriter, or dealer. An underwriter is defined as a

[1] For a complete copy of the adopting release, see SEC Release No. 33-8869 "Revisions to Rules 144 and 145" at http://www.sec.gov/rules/final/2007/33-8869.pdf.

person who purchases securities "with a view … to the distribution" of the securities. Rule 144 provides a non-exclusive safe harbor from the definition of an underwriter to permit investors to resell restricted securities and control securities without registration pursuant to the Section 4(1) exemption. Restricted securities are securities acquired directly from an issuer, including securities acquired in private placement offerings, Regulation D offerings, employee stock benefit plans, as compensation for professional services, or in exchange for providing start-up capital. Control securities refer to securities held by an affiliate of an issuer regardless of how the securities were acquired. A person who satisfies Rule 144 may resell restricted securities and control securities without registering these shares with the SEC.

Holding Period Shortened

Rule 144 requires that a person hold restricted securities for a period of time to demonstrate that he or she assumes economic risk upon acquisition of the securities and lacks an intent to distribute those securities.[2]

The amendments decrease the holding period to six months for restricted securities of issuers subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 (Exchange Act). The holding period for securities of issuers that are not subject to Exchange Act reporting requirements continues to be one year. These holding periods are the same for both affiliates and non-affiliates of the issuer.

Current Information, Volume Limitations, and Manner of Sale Requirements Liberalized

Prior to the amendments, both affiliates and non-affiliates were subject to all of the conditions of Rule 144, including public availability of current information about the issuer at the time of the resale, limitations on the volume of securities that could be sold at any time, requirements regarding the manner of the sale of the securities, and a requirement to file Form 144 with the SEC when sales exceed a certain dollar or volume threshold. The amendments to Rule 144 eliminate these conditions for non-affiliates except for the current information requirement, which now only applies when non-affiliates sell securities of Exchange Act reporting issuers prior to holding such securities for one year. After one year, the current information requirement ceases for non-affiliates. Affiliates continue to be subject to current information, volume limitations, revised manner of sale, and Form 144 filing requirements until 90 days after they cease to be affiliates.

Form 144 Filing Requirements Liberalized

Non-affiliates will no longer be required to file Form 144. Affiliates will continue to be required to file Form 144, but only if resales exceed 5,000 shares or $50,000 within a three-month period. Previously, the thresholds were 500 shares or $10,000. Although the proposed rules solicited comments on combining Form 144 and Form 4, the SEC has chosen to reconsider this issue in the future.

Application of Amendments to Rule 144

The table below summarizes the application of amended Rule 144 with respect to affiliates and non-affiliates:

	Affiliate (or Person Selling on Behalf of an Affiliate)	Non-Affiliate (and Has Not Been an Affiliate During the Prior 90 Days)
Restricted Securities of Reporting Issuers	<u>During the six-month holding period</u>: no resales permitted under Rule 144 <u>After the six-month holding period</u>: may resell in accordance with all Rule 144 requirements, including current public information, volume limitations, manner of sale requirements for equity securities, and filing of Form 144	<u>During the six-month holding period</u>: no resales permitted under Rule 144 <u>After the six-month holding period but before one year</u>: unlimited public resales permitted under Rule 144; current public information requirement still applies <u>After one-year holding period</u>: unlimited public resales permitted under Rule 144; need not comply with any other Rule 144 requirements
Restricted Securities of Non-Reporting Issuers	<u>During one-year holding period:</u> no resales permitted under Rule 144 <u>After one-year holding period</u>: may resell in accordance with all Rule 144 requirements, including current public information, volume limitations, manner of sale requirements for equity securities, and filing of Form 144	<u>During one-year holding period</u>: no resales permitted under Rule 144 <u>After one-year holding period</u>: unlimited public resales permitted under Rule 144; need not comply with any other Rule 144 requirements.

[2] *Although proposed, the SEC did not adopt a change to Rule 144 that would have required tolling the holding period while restricted securities are hedged. The adopting release states that the SEC staff will revisit this issue if they observe abuse relating to hedging activities.*

Manner of Sale Requirements Relaxed for Affiliates

The SEC has adopted two changes to the manner of sale requirements applicable to affiliates. First, Rule 144 was amended to permit the resale of securities through riskless principal transactions. Second, the term "brokers' transactions" has been redefined to allow brokers to insert bid and ask quotations for a restricted security in an alternative trading system if the broker has published bona fide bid and ask quotations for that security in the alternative trading system on each of the 12 preceding business days.

Affiliates Can More Easily Resell Debt Securities

Resales of debt securities by affiliates are no longer subject to the manner of sale requirements.[3] Additionally, the Rule 144 volume limitations have been amended to permit the resale of debt securities in an amount that does not exceed 10 percent of a tranche, aggregated with all sales of securities of the same tranche sold for the account of the selling security holder within a three-month period.

Codification of Various SEC Staff Positions

The amendments also codify several interpretative positions that have been issued over the years by the staff of the SEC's Division of Corporation Finance, as follows:

- Securities acquired pursuant to Section 4(6) of the Securities Act are considered restricted securities under Rule 144(a)(3).
- Security holders may "tack" their holding period when an issuer reorganizes into a holding company structure or when a conversion or exchange of securities from the same issuer occurs.
- Upon a cashless exercise of options or warrants, the newly acquired underlying securities are deemed to have been acquired when the corresponding options or warrants were acquired.
- Provided that pledgees have not acted in concert, a pledgee is not required to aggregate its sales of restricted securities with sales by another pledgee of the same securities when considering the applicable volume limitations. Therefore, pledgees will not be required to track and coordinate resale of restricted securities with other pledgees of the same pledgor.
- Rule 144 generally is not available for the resale of securities initially issued by a shell company. However, Rule 144 has been amended to permit the resale of securities issued by shell companies provided that (i) the issuer is no longer a shell company; (ii) it is subject to Exchange Act reporting requirements; (iii) it has timely filed its periodic reports for a period of one year; and (iv) at least one year has elapsed from the time the issuer filed current Form 10 type information with the SEC reflecting its status as a non-shell company.
- Form 144 has been revised to state that the filer was not trading on the basis of material, non-public information as of the date he or she adopted a written trading plan or gave trading instructions that satisfied Rule 10b5-1 of the Exchange Act.

Amendments to Rule 145

The final rules also amend Rule 145, which applies to the offer and sale of certain securities received in business combination transactions such as reclassifications, mergers, consolidations, and asset transfers. Previously, the presumptive underwriter doctrine under Rule 145(c) stated that affiliates of corporations that engage in a merger or sale of assets in exchange for

[3] *Non-participatory preferred stock and asset-backed securities and other non-convertible debt securities will all be treated similarly.*

securities were deemed to be underwriters under the Securities Act unless they resold the securities in accordance with certain requirements of Rule 144 or in a registered transaction. The amendments eliminate this doctrine except with respect to transactions involving shell companies. The resale provisions in Rule 145(d) also have been revised in a manner similar to the Rule 144 revisions. As a result of the revisions to Rule 145, affiliates of a target in a business combination may more easily resell securities received as consideration in accordance with revised Rule 145(d).

ABOUT FOLEY

The attorneys of Foley's Transactional & Securities Practice provide sophisticated legal advice on the issues most important to public and private companies, including all aspects of merger and acquisition transactions, capital markets transactions, securities matters, investment company matters, corporate governance and counseling, and other matters. We are a significant resource for organizations worldwide in need of insightful and innovative legal and business counsel.

Jay O. Rothman
Chair
Milwaukee, Wisconsin
414.297.5644
jrothman@foley.com

Foley.com

2008 Proxy Season: New Challenges and Opportunities

Edward J. Speidel, Senior Vice President
Ramanathan Kumar, Assistant Vice President
February 13, 2008

Today's Topics

- Proxy voting issues and shareholder concerns
  - Current environment
  - 2008 shareholder initiatives
- Proxy advisor policies and evaluation criteria
  - Key proxy advisors
  - Policy/evaluation criteria
  - 2008 proxy developments
- The Compensation Discussion and Analysis (CD&A): Year two
  - SEC guidance
  - Preparation for 2008
- Summary

2

Proxy Voting Issues and Shareholder Concerns

CURRENT ENVIRONMENT

Legislative Initiatives and the Media are Raising the Stakes…and the Pressure

- *"The 2008 proxy season will be much as it was last year. Compensation will again be a main focus."*

Charles Elson, President of University of Delaware's Weinberg Center for Corporate Governance

External Pressures		
Legislative	Regulatory (SEC)	Media
• H.R. 1257 (Barney Frank) • S. 1181 (Barack Obama)	• CD&A comment letters • SEC's Executive Compensation Reader • Additional SEC guidance	• San Jose Mercury News • Wall Street Journal • New York Times

- The transparency of the new disclosures has heightened awareness, calling even greater attention to cases of real (or perceived) excess

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CURRENT ENVIRONMENT

A New Sense of "Pay Reasonableness" is Taking Hold

- Linkage between executive pay and performance
- CEO pay relative to other executives and other employees (internal equity)
- Rationale/justification for perquisites and retirement benefits
- Appreciation for the appropriate use of equity
  - "All-in" wealth creation
  - Holding requirements/ownership guidelines
- Rationale/justification for executive contracts
  - "Pay for failure" severance payments and equity acceleration
  - Change-in-control excesses: single triggers, 280G gross-ups, aggregate severance levels

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CURRENT ENVIRONMENT

Early Leaders in the "Race to Reform"

No CEO Employment Agreement	"Cap" on Severance Multiple	Conservative Severance Benefits	Waiving Compensation Elements	No Supplemental Executive Benefits
• Cisco • Intel • Pfizer	• Cardinal Health • Electronic Data Systems • Hewlett Packard • Verizon	• Intuit – 6 months base salary continuation • Cardinal Health – Tenure-based multiple • Brightpoint Systems	• Microsoft, Amazon – No CEO options	• Intel

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CURRENT ENVIRONMENT

2007 By the Numbers – Key Proxy Voting Results

Type of Proposal		2006 # of Proposals	2006 Average "For" Vote	2007 # of Proposals	2007 Average "For" Vote
Management Proposals					
Equity Compensation Plans	• ISS recommendations *for*	1,419	70%	***1,400+***	***62%***
Shareholder Proposals					
Executive Compensation	• Vote on future golden parachutes	12	50.0%	***11***	***52.5%***
	• Link pay to performance	23	36.1%	***40***	***28.1%***
	• Use performance-based equity	17	36.6%	***25***	***31.9%***
	• Adopt policy on SERPs	4	41.9%	***15***	***32.9%***
	• Allow advisory vote on compensation	7	40.1%	***52***	***43.2%***
	• Recoup unearned bonuses	10	23.6%	***10***	***31.9%***
Governance	• Majority vote to elect directors	84	47.7%	***37***	***50.3%***

Source: ISS 2007 Post-Season Report (www.issproxy.com). 2006-2007 data for six-month period from January 1-June 30

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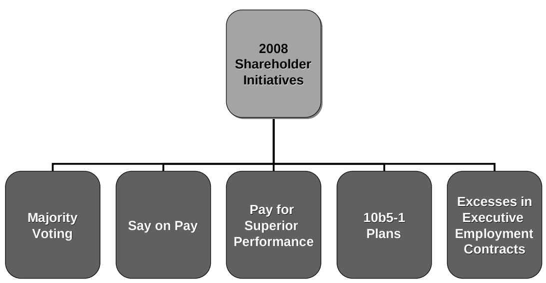
2008 SHAREHOLDER INITIATIVES

Shareholders Intend to Take Action on Key Compensation Issues in 2008



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2008 SHAREHOLDER INITIATIVES

Majority Voting

- In a standard (uncontested) election, directors at most US companies are elected by plurality vote

The Problem	The Proposed Solution
• The director with the most "yes" votes will be elected to a given seat, regardless of the number of "no" votes – Since the vast majority of elections are uncontested, with only one nominee per open seat, directors are assured election (or re-election) upon receipt of the first affirmative vote	• Adopt majority vote requirements such that a director must receive more affirmative than negative votes to be elected to the board – 44% of S&P 500 companies have adopted majority vote bylaws or charter provisions to date

- Adobe, eBay and Pfizer adopted full majority vote standards within the last six months
- The majority of proposals target S&P 500 companies

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2008 SHAREHOLDER INITIATIVES

Say on Pay

- Unlike their European counterparts, investors in the US have no formal opportunity to be heard on companies' overall executive compensation philosophy/practice

The Problem	The Proposed Solution
• US investors currently have the ability to vote only on a narrow slice of pay practices related to equity compensation – e.g., approval/replenishment of equity compensation plans	• Adopt charter or bylaw provisions that require an annual non-binding vote on the totality of executive compensation programs as described in the CD&A

- Three companies – Par Pharmaceuticals, Verizon and Aflac – have already adopted some variation of "say on pay" for 2008
- 90 proposals calling for a "say on pay" bylaw/amendment have been submitted thus far in 2008, generally targeting companies where compensation and/or corporate performance has been an issue
  - Abbot Laboratories, Lexmark, Capital One and Wells Fargo are among early recipients
  - Thus far, majority votes in favor have been received by Motorola, Verizon, Ingersoll-Rand, Blockbuster, Valero Energy, Clear Channel and Activision

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2008 SHAREHOLDER INITIATIVES

Pay for Superior Performance

- For the third year running, investors are prepared to submit a large number of proposals advocating stronger links between executive pay and performance

The Problem	The Proposed Solution
• Investors continue to believe that overall executive pay levels are too often disconnected with company performance (financial and stock price) – In particular, high payouts made to executives of average (or below-average) performing companies based on industry-wide events	• Set performance metrics relative to peer performance rather than targeting absolute levels • Require that a minimum threshold (i.e. a majority) of LTI awards be performance- rather than time-based

- Approximately two dozen such proposals garnered average support of 36% in 2006; in 2007, the number of such proposals increased by more than 50%

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2008 SHAREHOLDER INITIATIVES

Adopt Controls on Rule 10b5-1 Plans

- Adopted by the SEC in 2000, rule 10b5-1 provides flexibility to insiders who might often be captured in blackout periods by allowing the establishment of automatic trading protocols that operate regardless of insider trading windows

The Problem	The Proposed Solution
• Some investors believe loopholes allow executives to game the system, canceling trades or modifying trading protocols to their advantage while in possession of nonpublic information – A 2007 Stanford study suggests the rule does not prevent "strategic trades," and the SEC has announced it is investigating possible abuses (Jagolinzer, Alan D., "Sec Rule 10b5-1 and Insiders' Strategic Trade" (September 17, 2007). Available at SSRN: http://ssrn.com/abstract=541502 or DOI: 10.2139/ssrn.541502)	• Limiting amendments or early termination • Prohibit broker handling 10b5-1 trades from handling any other trades for the same executive • Adopt 90-day waiting period from adoption to first trades made under the plan • Absolute bar on any executive trades in the company's own stock outside of a 10b5-1 • Identify and disclose all transactions on Form 4s

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2008 SHAREHOLDER INITIATIVES

Excesses in Executive Employment Contracts

- Executives enter into employment agreements dictating the terms and conditions of payment upon termination

The Problem	The Proposed Solution
• Executive contracts are increasingly perceived as conveying excessive benefits to executives, particularly in the event of a termination ("pay for failure") • Investors are beginning to argue that contracts are appropriate only during an initial term after a new executive comes on	• Cap terms at three-years; prohibit automatic renewal • Bar contractual provisions that accelerate vesting of equity awards in various termination scenarios – CalPERS proposal would require double-triggers for any severance benefit to accrue to executives • Bar contractual gross-ups

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Proxy Advisor Policies and Evaluation Criteria

KEY PROXY ADVISORS

Who Are the Proxy Advisors?

Area	ISS	Glass Lewis
Coverage Universe	• 10,000+ US • 25,000+ Global	• 5,000+ US • 2,000+ Global
Quantitative Methodology	• Total cost (binomial)	• Annual cost (binomial)
Key Analytics/Procedure	• Shareholder Value Transfer (SVT) • Burn rate • CEO pay-for-performance • Repricing	• Enterprise value • Financial performance • Cost per employee

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POLICY/EVALUATION CRITERIA

ISS Uses a Four-Pronged Test to Evaluate Equity Compensation Plans

- In 2007, ISS voted against roughly 38% of the equity plans it evaluated

Total Cost SVT

- Binomial cost vs. Global Industry Classification Standard (GICS) industry comparator group
- Approximately 50% of negative plan votes due to excessive SVT alone

Burn Rate

- Three-year historical gross burn rate vs. GICS industry comparator group
- Volatility-based multiplier on full-value awards

Pay-for-Performance

- CEO pay vs. one- and three-year total shareholder returns
- Also used to evaluate Compensation Committee performance

Repricing

- Explicit authorization or history of repricing
- NASDAQ and AMEX companies

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POLICY/EVALUATION CRITERIA

Burn Rate Limits for High-Tech and Life Sciences

Burn Rate

	Russell 3000			Non-Russell 3000		
	ISS Limit			ISS Limit		
Industry	2007	2008	Change	2007	2008	Change
Pharmaceuticals and biotechnology (GICS 3520)	4.50%	**4.96%**	▲	6.85%	**8.69%**	▲
High-technology						
Software/Services (GICS 4510)	5.82%	**6.11%**	▲	8.46%	**9.27%**	▲
Hardware (GICS 4520)	4.70%	**4.80%**	▲	5.92%	**5.83%**	▼
Semiconductors (GICS 4530)	5.40%	**5.59%**	▲	6.94%	**6.81%**	▼

- **Option burn** decreased across all industries, while **stock award burn** increased, illustrating shift from options to full-value grants particularly among larger (Russell 3000) companies
- ISS' methodology for calculating annual burn has changed in 2008
  - Weighted average common shares outstanding rather than year-end outstanding
  - Additional volatility-based buckets for full-value grants

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POLICY/EVALUATION CRITERIA

Shareholder Value Transfer Limits for High-Tech and Life Sciences

Total Cost SVT

Industry	2007 SVT Limits
Pharmaceuticals and biotechnology (GICS 3520)	15%-17%
High-technology	
Software/Services (GICS 4510)	16-18%
Hardware (GICS 4520)	14-16%
Semiconductors (GICS 4530)	15-18%

- SVT reflects the binomial value of the stock option programs
- Corresponding overhang levels vary by company/industry, but are generally 25% to 50% higher than the SVT percentage among high-technology and biotechnology firms

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POLICY/EVALUATION CRITERIA

Compare: Institutional Guidelines on Overhang and Burn Rate

Burn Rate

- A handful of institutions have their own guidelines on burn rates
- TIAA-CREF – 3% for "human capital intensive" industries
- Vanguard – 2% guideline

Issued and Outstanding Overhang

- Typical institutional guideline: issued + available overhang should equal no more than 10-15% outstanding common
- For large-cap, mature high-tech and biotech companies, general threshold in the area of 15%
- For small-cap, development stage companies, 20% or slightly more may be tolerated

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2008 POLICY DEVELOPMENTS

ISS is Fine-Tuning the Way It Evaluates Compensation Programs

Issue	Existing Policy	New Policy
• **Shareholder Value Transfer (SVT)**	• Market capitalization = basic common + convertible preferred, debt, and warrants • Restricted shares valued at a discount to face	• Market value based only on basic common shares outstanding • Restricted shares valued at face • Vested option carve-out: in select instances, vested, in-the-money overhang may be carved out of ISS' SVT calculation
• **Burn Rate**	• Annual calculation as percent of fiscal year end basic common outstanding • Three volatility-based buckets yield restricted share multipliers	• Annual calculation as percent of weighted average basic common outstanding • Restricted share multipliers based on six volatility-based buckets

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2008 POLICY DEVELOPMENTS

ISS is Fine-Tuning the Way It Evaluates Compensation Programs

Issue	Existing Policy	New Policy
• **Poor Pay Practices**	• Egregious SERP provisions • Overly generous CEO new hire packages • Excessive severance/change-in-control provisions/payments • Internal pay disparity • Backdating • Mid-year changes to performance metrics • Other	• Examples of poor practices expanded to include: – Contractually-guaranteed base salary increases – Excessive perquisites (as % of base salary) – Perquisites for *former* executives – Poor disclosure

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2008 POLICY DEVELOPMENTS

Designing an ISS-Friendly Plan

- Delineate appropriate limits on full-value share awards
  - Omnibus pool vs. fixed full-value sub-limit vs. fungible pool
- Proactively address repricing
  - Shareholder approval for amendment, replacement, or cash buyback of underwater options
- Share recycling and net-settled provisions
  - When included, such provisions inflate the ISS-calculated cost of the plan
- Change-in-control provisions
  - Modest (50%+ acquisition) or none at all
- Transferability

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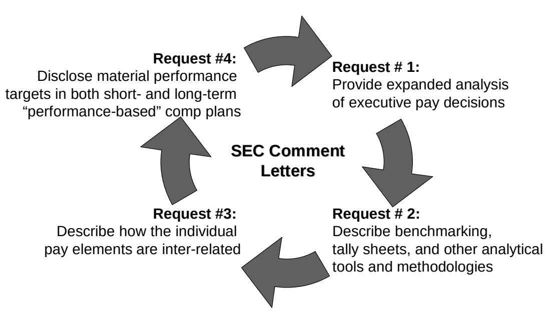
Compensation Discussion and Analysis (CD&A): Year Two

SEC GUIDANCE

Key Comments/Requests by the SEC



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SEC GUIDANCE

SEC Request #1: Enhanced *Analysis* of Executive Pay Decisions

Companies need to discuss not only the *what* but also the *how* and *why* of each element of executive compensation

- **What** was actually delivered to the executive(s)?
- **How** did the Compensation Committee arrive at the amount of each element paid – what process and analytical tools were employed?
- **Why** did the Compensation Committee pay the actual amount delivered to the executive?
  - In particular, the need to justify payout well above or below the targeted philosophy, **as well as differing payouts made to different executives**

Examples:

- Becton Dickinson, Schering Plough (particularly the discussion of equity grants)
- Dell (integration of compensation philosophy and business strategy)
- Mindspeed (detailed description of performance/pay of each named executive officer)

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SEC GUIDANCE

SEC Request #2: Detail Benchmarking, Tally Sheets and Other Analytical Tools

The CD&A should describe how tally sheets, benchmarking and summaries of wealth accumulation factored into the Compensation Committee's deliberations

- What did these tools **show**?
- What **judgments** did the Committee make on the basis of the data?
- What **specific actions/decisions** were taken by the Committee as a result of its analysis?

Examples:

- Inspire Pharmaceuticals, Google – detailed tables with peers by name and financial/other criteria
- Becton Dickinson – discussion of tally sheet use

Note: Radford Executive Survey has commonly been sourced as an additional source of market data

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SEC GUIDANCE

SEC Request #3: Describe Interplay of Various Elements of Executive Pay

The CD&A should not only explain each element of executive pay in isolation, but also discuss how delivery of one element may have impacted decisions on other elements of pay

- What is targeted level of **overall compensation vs.** the market?
- What does the Compensation Committee target in terms of **long-term vs. short-term** pay, and **fixed vs. variable** compensation?
  - How might the mix vary between the CEO, other members of the C-suite, and other executives?

Examples:

- AMI Semiconductor
- Apple
- Dell

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SEC GUIDANCE

SEC Request #4: Disclose Material Performance Targets

Companies should disclose material performance targets in both short-term (bonus) and long-term "performance-based" comp plans unless omission can be justified under the "competitive harm" standard

- If a given target is material to the program, it should be disclosed unless
  - It is a confidential trade secret or financial information whose disclosure might cause competitive harm
- If a material metric is omitted under this standard, explain the unique characteristics of the industry or the metric that would make disclosure to competitors harmful
  - Also disclose in detail the level of difficulty of achieving the target level of performance
  - In a context that is amenable to easy comprehension – e.g., compare to last year

Examples:
- Northrop Grumman
- EMC
- Biogen Idec

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PREPARATION FOR 2008

What Investors are Looking for in the 2008 CD&A

- Performance linkages
  - Is the compensation plan performance based?
  - Does it promote long-term value creation (that is, is it aligned with shareholders)?
- Suitability/appropriateness for the company
  - Is the plan related to the company's business strategy? Does the CD&A support the MD&A?
  - Is the plan customized to suit the company's size, industry, performance, and competitive position?
- Clear, complete and understandable
  - Are the plan's metrics, hurdles and goals clearly and specifically disclosed? Are they understandable? Do they make sense?
  - Does the plan articulate a coherent compensation philosophy appropriate to the company and clearly understood by directors?

Does the program avoid abuses? ***Are we convinced?***

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SUMMARY

2008 Key HR/Compensation Action Items

- Identify current areas of vulnerability in compensation programs, processes, and/or disclosure
  - Understand distinct pay-for-performance disconnects and Compensation Committee practices that could draw "withhold" votes
- Assemble a team (internal and external) early and coordinate efforts
- Understand your institutional base
  - Their unique policies/perspectives on executive pay and/or share requests
- Review last year's CD&A in context of SEC comments
  - 2007 was a "free pass," but 2008 could see enforcement or other negative consequences for CD&A shortfalls
- Review any feedback from investors, proxy advisors, SEC
  - ISS, Glass Lewis, CGQ

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Questions?
Thank You!

Contact Information
Edward J. Speidel, espeidel@radford.com, +1 508 460-2038
Ramanathan Kumar, rkumar@radford.com, +1 212 441-2007

Typical Performance Awards

- Performance Awards are becoming more prevalent in current FAS123R environment
  - Prior FAS123 had negative accounting consequences
  - Normally found with full value shares, since stock options are inherently a performance vehicle
  - Can be defined as Performance Conditions or Market Conditions
  - Performance Conditions
    - Typically based on internal metrics such as EBITDA, EPS, or Revenue
    - Need to expense the actual number of awards that vest and reconcile
  - Market Conditions
    - Typically based on a fixed stock price or Total Shareholder Return ("TSR")
    - May better align compensation delivered and shareholder return
    - Do not get to reverse charge if market condition is not met

1

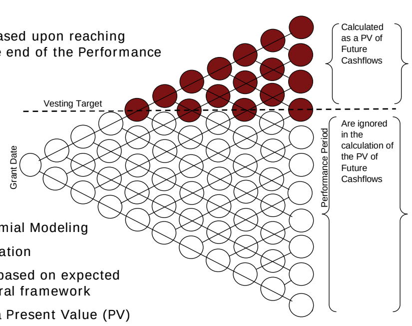
Common Types of Performance Plans with Market Conditions

- Absolute Market Conditions
  - Vesting contingent on reaching certain stock hurdles
  - Generally seen for top couple of Executives
  - Influenced by general market movements
  - Creates a discount comparatively against FAS123R charge of normal full value share absent the vesting hurdle
- Relative Market Conditions
  - Depending on percentile rank after performance period, a percentage of awards will vest
  - More broad based in distribution
  - Normalized against general market movements
  - Will not necessarily create a discount from original FAS123R fair value if upside opportunities exist
  - Challenge of picking reliable peers

2

Absolute Market Conditions - Valuation

- Share only vests based upon reaching vesting target at the end of the Performance Period



- Requires either Binomial Modeling or Monte Carlo simulation
- Project stock prices based on expected volatility in Risk-Neutral framework
- Discounted back to a Present Value (PV)

3

Absolute Market Conditions – Sample Results

- The following charts depict the reduction in fair value of a hypothetical restricted share grant that contains a market condition. The market condition stipulates that the share only vests if reaching certain price levels at the end of the 4 year performance period. Based on a 5% risk-free rate, and no dividend yield.

		Vesting Hurdle					
		0.00%	5.00%	10.00%	15.00%	20.00%	25.00%
Volatility	20.00%	-27.56%	-32.46%	-37.47%	-42.35%	-47.12%	-51.92%
	30.00%	-29.26%	-32.50%	-35.96%	-39.26%	-42.43%	-45.48%
	40.00%	-28.55%	-31.04%	-33.40%	-35.80%	-38.01%	-40.58%
	50.00%	-26.97%	-28.84%	-30.74%	-32.76%	-34.49%	-36.55%
	60.00%	-24.87%	-27.19%	-28.75%	-29.75%	-31.57%	-32.73%
	70.00%	-22.59%	-24.42%	-25.69%	-26.15%	-27.93%	-28.15%
	80.00%	-20.84%	-21.30%	-22.50%	-24.60%	-24.41%	-25.91%

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4

Relative Market Conditions - Provisions

- Depending on percentile rank after performance period, a percentage of awards will vest
- Can provide upside opportunities (generally up to 200%) if outperform comparator companies
- Most common Performance Period is 3 Years
- Recommend to have at least 20 comparators
  - What to do if somebody drops out (i.e. business combinations, changes in the Index, etc.)
- Generally see 20 day or greater averaging period

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5

Relative Market Conditions - Example

Rank	Company	TSR	
1.	Peer Comparitor I	19.81%	200% vest if above the 75th Percentile
2.	Peer Comparitor C	19.21%	
3.	Peer Comparitor E	19.07%	
4.	Peer Comparitor J	18.04%	
5.	Peer Comparitor S	17.42%	
6.	Peer Comparitor N	16.39%	Number of awards vesting will be interpolated between 0% and 200% based upon actual percentile rank
7.	Peer Comparitor G	16.32%	
8.	Peer Comparitor Q	14.55%	
9.	Peer Comparitor L	14.43%	
10.	Peer Comparitor D	13.61%	
11.	Peer Comparitor K	12.77%	
12.	Peer Comparitor T	9.68%	
13.	Peer Comparitor O	7.27%	
14.	Peer Comparitor F	7.15%	
15.	Peer Comparitor H	6.09%	
16.	Peer Comparitor M	4.89%	0% vest if below the 25th Percentile
17.	Peer Comparitor B	4.64%	
18.	Peer Comparitor P	4.09%	
19.	Peer Comparitor R	3.82%	
20.	Peer Comparitor A	3.28%	
	Company	12.07%	
	Median	13.19%	
	Average	11.63%	
	Rank	12	
	Percent To Vest	85%	

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6

Relative Market Conditions - Valuation

– Very challenging modeling techniques
- Requires Monte Carlo simulation
- Generally done in a "risk-neutral" framework
- Projects stock prices for Company and each relative peer company, including the underlying correlation of stock prices in the projection
- Projected stock prices are not only used for determination of expected awards to vest, in addition to the discounting of future cashflows

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Relative Market Conditions – Recent Adopters

Market Conditions Company	Perf. Period	Index?	Number of Peers	Averaging Period	Number of Bendpoints	Maximum Bendpoint	50% Bendpoint	Filing Date
PG&E	3	No	12	30	3	200%	75%	12/22/2006
Lexington Realty Trust	5	No	N/A	N/A	N/A	N/A	N/A	1/3/2007
Equity Inns	3	NAREIT	15	N/A	N/A	150%	100%	1/5/2007
AMR Corporation	3	No	N/A	N/A	N/A	N/A	N/A	1/17/2007
Overseas Shipholding group	3	No	18	N/A	N/A	N/A	N/A	1/17/2007
Dow Jones	3	Publishing & Media	N/A	N/A	4	150%	100%	1/23/2007
Home Depot	3	S&P 500	500	N/A	3	300%	100%	1/24/2007
American Express	3	S&P 500	500	N/A	N/A	N/A	N/A	1/26/2007
Time Warner	3	S&P 500	500	N/A	N/A	200%	N/A	1/26/2007
Corn Products International	3	No	30	N/A	N/A	200%	N/A	1/29/2007
Nationwide Health Properties	3	NAREIT	15	N/A	N/A	200%	N/A	2/5/2007
Treehouse Foods	2.5	No	N/A	N/A	N/A	N/A	N/A	2/5/2007
Dollar Thrifty Automotive	3	Russell 2000	2000	N/A	N/A	N/A	N/A	2/6/2007
BearingPoint	3	S&P 500	500	20	N/A	250%	N/A	2/8/2007
Gilead Sciences	3	IEX Biotech Pharmaceutical Inc	N/A	N/A	N/A	200%	100%	2/9/2007
Hershey Foods	3	Peer group	N/A	N/A	N/A	250%	N/A	2/13/2007
Ameren Corporation	3	Utility Peer Group	N/A	N/A	N/A	200%	N/A	2/15/2007
Hubbell Corporation	3	S&P Midcap 400	400	N/A	7	200%	100%	2/15/2007
Strategic Hotels & Resort	1	Bloomberg Hotel REIT	N/A	N/A	N/A	200%	100%	2/20/2007
NewField Exploration	3	No	22	20	22	200%	140%	2/21/2007
MDU Resources	3	No	28	0	4	200%	100%	2/21/2007
IDEARC Inc.	3	Not well Disclosed	N/A	N/A	N/A	150%	N/A	2/22/2007
Nordstroms	3	Not Disclosed	N/A	30	8	125%	80%	2/26/2007
Northwest Natural Gas	3	No	10	90	10	200%	60%	2/27/2007
Allegheny Technologies	3	Not Disclosed	N/A	30	4	300%	100%	2/27/2007
Edison International	3	Philadelphia Utility Index	20	20	3	200%	100%	2/27/2007
AES Corporation	3	S&P 500	500	0	2	150%	75%	2/28/2007
International Flavors & Fragrances	3	S&P 500	500	20	N/A	N/A	N/A	3/12/2007
Glimcher Realty Trust	3	Other REITS	16	N/A	N/A	200%	N/A	3/14/2007
CBS Corporation	3	S&P 500	500	10	3	300%	100%	3/16/2007
Applebees	3	Bear Sterns Index	24	200	4	150%	50%	3/20/2007
Chevron Corporation	3	Not Disclosed	4	20	4	200%	N/A	4/3/2007
TXU Corporation	3	Electric Utilities Index	N/A	N/A	N/A	200%	N/A	4/5/2007
Average			291	38	6	203%	93%	
Median			28	20	4	200%	100%	

AON 8