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December 29, 2006

GOOGLE ANNOUNCES NEW TRANSFERABLE STOCK OPTION PROGRAM

Google has developed an innovative program that will permit employees below the Executive Management Group to sell vested stock options to third-party financial institutions. This will allow employees to realize an option's "time value" in addition to its "intrinsic value" as part of the ongoing equity compensation program. The Transferable Stock Option program will impact all options granted since the Company's initial public offering as well as future awards. Unlike one-time transferable option programs at other companies (e.g., Microsoft[1]), the Google program is an ongoing auction with multiple financial institution participants.

On December 12, 2006, Google announced its new Transferable Stock Option (TSO) program, which will allow employees to sell their vested options to financial institutions through a competitive bidding process. This new feature represents an enhancement to the current option program since participants will now be able to realize both the option's intrinsic value as well as a portion of the remaining time value. In other words, financial institutions will pay a premium to buy the options from employees and exercise them at a later date.

PROGRAM DETAILS

The TSO program is expected to commence during the second quarter of 2007 and will generally operate as follows:

- Only employees below Google's Executive Management Group will be eligible to participate.
- Participants will be permitted to either (1) exercise their vested options (as under the existing program), or (2) sell their vested options to third-party financial institutions through an online auction managed by Morgan Stanley.
    - Employees will use a company web tool to view the highest price offered by participating financial institutions for the options, which is expected to be similar to the public market trading prices of listed stock options with similar maturities.

[1] Refer to our letter "Transferable Stock Options: Microsoft's Program" dated October 31, 2003 for a more detailed description of the program.

    - Google is currently working with several financial institutions to participate in the auction.

- Vested options granted on or after the date of Google's initial public offering will be eligible for sale.

    - In order to permit the sale of previously granted options, the provisions of these grants will be amended to permit transferability.

    - All new stock options granted will include the necessary provisions to allow for their sale.

- Options currently have a ten-year term; however, once sold to a third party, the option will expire two years from the date of transfer or on the original expiration date of the option, if earlier.

    - Options with a remaining term of less than six months are not eligible for sale under the program.

    - No further transfers to the public will be permitted after employees sell their options to a financial institution.

- Accounting costs will increase relative to the existing program as follows:

    - For currently outstanding options, there will be a compensation charge equal to the difference between the value of the modified stock options and the value immediately prior to modification, as measured using the Black-Scholes-Merton option pricing model.

        - The charge will be taken on the date the program is initiated for all vested options and over the remaining vesting periods for unvested options.

    - New grants will have a higher value than under the existing program based on the Black-Scholes-Merton model, since the options will now have a longer expected life (i.e., the options will have an additional two-year life beyond the current expected exercise period of approximately four years, which Google does not expect to change).

ADVANTAGES

The following are major advantages of Google's new TSO program:

- Compensation expense will be more closely aligned with pay delivery.

  - Compensation delivery is generally ensured even if options are underwater, which eliminates the need to take "corrective" measures (e.g., repricing, additional grants, etc.) for grants that have lost their incentive and retention value.

- Transferable options are more similar to restricted stock (versus non-transferable options) in that there is immediate value upon grant; however, participants will have the ability to time their taxable income, whereas restricted stock is taxable at vesting.

- Employees will have a higher perceived value of the options, which results in a greater retention and motivational impact.

- Google will be able to grant a lower number of option shares to deliver the same compensation value (if desired) since option value per share will be higher than options without the transferability feature.

- Amounts realized by participants from financial institutions will remain tax deductible by Google.

- Competitive bidding by several financial institutions will help ensure that employees will receive a fair price for their options.

- The aggregate number of outstanding options held by employees (i.e., overhang) will be reduced, even if options are underwater, which could potentially allow Google to replenish stock plans more often (i.e., shareholders are generally more likely to approve new share authorizations when overhang is low).

- Although compensation-related expense is projected to be higher than the current program, there may be a partial offset in the future if employees transfer options earlier than expected to take advantage of the option's immediate time value (i.e., there will be a lower cost if the expected exercise period in the future is lower than currently projected).

<u>DISADVANTAGES</u>

The following are major disadvantages of the program:

- Employees will be able to realize compensation value in the event of flat or declining stock price performance.

- Institutional investors and related advisory services (e.g., Institutional Shareholder Services) may not distinguish between options held by employees and those transferred to financial institutions in calculating overhang, which could negatively impact their opinion on new stock plan authorizations.

  - Financial institutions are less likely than employees to exercise options before their expiration date, which could also contribute to a higher number of options outstanding at any given time.

- Employees will likely dispose of their options earlier, since the awards will have an immediate time value; this will mitigate the impact that options have on aligning employee and shareholder interests.

- Stock-related compensation expense will increase for new options and previously outstanding options affected by the program.

THE FUTURE

Previous programs that permitted third-party transferability were implemented on a one-time basis and covered only underwater options (e.g., Microsoft). Google's program represents the evolution of this idea and may impact the way companies use equity to compensate employees in the future. If the TSO program proves to be successful, it is likely that other companies will follow with similar programs, especially among those that continue to embrace options. However, high potential administrative costs associated with such programs could deter their use at smaller companies.

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This letter is intended to alert compensation professionals about developments that may affect their companies. General questions about Google's TSO program may be addressed to Michael Chavira in Los Angeles at (310) 734-0108. This letter and other published materials are available on our website, www.fwcook.com.