FREDERIC W. COOK & CO., INC.

THE 2005 TOP 250

Long-term Incentive
Grant Practices for Executives

AUGUST 2005

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Three years into renewed efforts to improve corporate governance, executive compensation remains under close scrutiny and in a period of transition. During 2004, the Financial Accounting Standards Board (FASB) finalized the accounting mandate for stock option expensing while shareholders continued to demand greater accountability in executive remuneration. In general, this mandate, "Statement 123(R), Share-Based Payment," requires companies to record the compensation cost for equity awards, including stock options, based on a "modified grant-date fair value" methodology – an approach to equalize the accounting treatment for all types of equity-based incentive intended for fiscal years beginning after June 15, 2005. As a result, companies continue to evaluate and adjust their long-term incentive (LTI) strategies and, in particular, their equity grant practices.

Many companies, however, have already begun to expense stock options as prescribed in Financial Accounting Standard 123, which we believe can provide insights into future practice. As such, these so-called "FAS 123 companies" were analyzed separately and compared to "Non-FAS 123 companies" in an effort to identify the likely future practices of all companies under the accounting mandate.

Key findings from Frederic W. Cook & Co.'s research on long-term incentive practices at the Top 250 companies include the following:

- **"EARLY ADOPTERS" OF OPTION EXPENSING LEAD THE WAY IN LTI GRANT PRACTICES: PERFORMANCE AWARDS GAIN FAVOR** — These bellwethers, "early adopters" of option expensing, continue to adjust long-term incentive design and grants in order to improve financial efficiency. While options and restricted stock are the most prevalent LTI vehicles in use, the prevalence of performance awards has increased significantly. Specifically, 71 percent of FAS 123 companies versus 55 percent of Non-FAS 123 companies grant performance awards. These trends will likely become more pronounced as all companies adopt the new accounting standard.
- **LTI MIX AND USE HAS SHIFTED AWAY FROM STOCK OPTIONS AND TOWARDS OTHER GRANT TYPES** — While the majority of CEO LTI value is still delivered through options, companies have shifted the LTI grant mix towards restricted stock and other types of full-value awards. The prevalence of stock options (83 percent), restricted stock (72 percent), and performance awards (71 percent) is converging among FAS 123 companies. In addition, FAS 123 companies are increasing use of stock-settled stock appreciation rights.
- **CEO LONG-TERM INCENTIVE VALUES HAVE STABILIZED** — Actual CEO long-term incentive values have stabilized over the 2002 to 2004 period after declining from 2001 to 2002. Furthermore, "outliers" (companies at or above the 75th percentile) have moved closer to the median.

The details underlying these key findings are presented, along with additional analyses and information, in the following pages.

INTRODUCTION

BACKGROUND AND OVERVIEW

Since 1973, **Frederic W. Cook & Co.** has extensively researched and published annual reports on long-term incentive grant practices for executives. This 2005 report, our 33rd edition, presents information on long-term incentive (LTI) and stock-based grant types currently in use for executives of the 250 largest U.S.-based companies in the Standard & Poor's 500 Index as reported in the Special Spring 2005 issue of *Business Week* magazine. Selection of these companies was based on their total market capitalization, i.e., share price multiplied by total common shares outstanding, as of February 28, 2005.

SURVEY SCOPE

The following topics are covered in this report:

- Long-term incentive grants
- Stock option variations
- Other grant type variations
- Mandatory payment of annual incentives in equity
- Comparison of grant type practices for FAS 123 companies (that currently expense options) and Non-FAS 123 companies
- CEO long-term incentive grant analysis that compares award types and actual award levels from 2002 to 2004
- Long-term incentive grant practice evolution
- Executive stock ownership guideline prevalence

The information in this report is presented both in summary form and on a company-by-company basis. Definitions for each grant type appear in the *Appendix*.

OTHER SURVEY PARAMETERS

Similar to previous reports, the following data are based on publicly disclosed information in company proxy statements, annual reports, 10-Q and 10-K filings. New to this year's report is information that was disclosed in Form 8-K filings. Form 8-K disclosure is mandated under the Sarbanes-Oxley Act of 2002 whereby disclosure is required for, among other things, material changes relating to compensation and benefit arrangements. The significance of this approach is that the results more closely reflect "real time" and may represent current-year (i.e., 2005) rather than prior-year (i.e., 2004) practice.

It should be noted that comparisons to prior year practices, other than those relating to the CEO analysis, do not reflect a constant company population, since, as noted above, a snapshot of company size determines inclusion in this report. In terms of the 2005 Top 250 sample, a total of 27 companies, representing 11 percent of the companies reviewed, are new to this year's report. Therefore, "trend" data can be influenced by changes in the company sample from year-to-year, as well as actual changes in grant usage. In terms of the CEO analysis, this year's sample is generally consistent for all periods shown in the report while the sample does differ slightly from that used in last year's 2004 Top 250 report.

Note that in some circumstances totals may not add up to 100 percent due to rounding.

EXECUTIVE LONG-TERM INCENTIVE GRANTS

The information presented throughout this report focuses on long-term incentive grants currently in use or expected to be in use in the near future, rather than on the company's ability to make a particular type of grant. A grant type is generally considered to be in use at a particular company if grants have been made within the latest three fiscal years and there is no evidence that this granting practice has been discontinued, or if the company indicates that the grant will be used prospectively. As noted earlier in this report, the data primarily reflect usage through fiscal year 2004, but the findings do, whenever possible, present more current grant practices for fiscal year 2005.

To be considered a "long-term incentive" for purposes of this report, a grant must possess the following general characteristics:

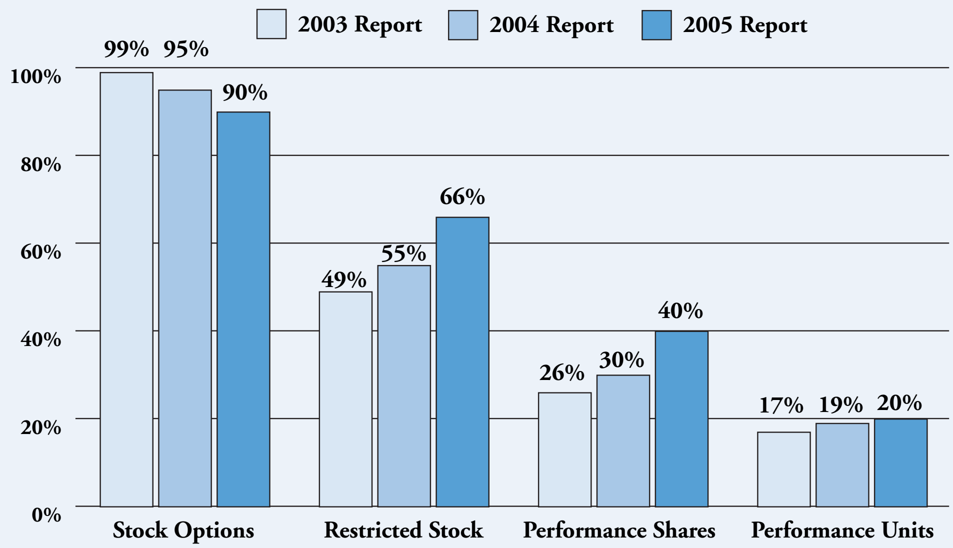
- The grant type must be made under a formal plan or practice, and may not be limited by both scope and frequency. A grant with *limited scope* is awarded to only a handful of key executives. A grant with *limited frequency* is an award that is not made consistently and appears to fall outside the principal LTI program. Therefore, a grant determined to be made specifically as a hiring incentive, replacement of lost benefits upon hiring, or promotional award is typically excluded. A grant with limited scope but without limited frequency may be considered a long-term incentive, and vice versa.
- The grant type must not be delivered primarily to accommodate foreign tax or securities laws. For example, a company that grants stock appreciation rights (SARs) in foreign countries as an alternative to the normal award of stock options in the U.S. is not considered to grant SARs as a long-term incentive.

In an effort to identify trends in long-term incentive grant practices, grants have been classified into either of the following categories:

Continuing	Historical and/or continuing grants
New	New (latest or current fiscal year) <u>or</u> future (indicated in proxy statement or Form 8-K) grants
Dropped	Eliminated or to be discontinued grants

SUMMARY OF MAJOR EXECUTIVE LONG-TERM INCENTIVE GRANT TYPES IN USE

Executive Long-Term Incentive Grant Type Usage – Percent of Top 250 Companies



Stock Options are rights to purchase company stock at a specified exercise price over a stated option term, and represent the most widely used long-term incentive grant type among Top 250 companies. Seventeen of the Top 250 companies that used options in the past have dropped stock options from their long-term incentive programs this year or expect to do so next year. Variations of the "plain vanilla" stock option are summarized in greater detail later in this report.

Restricted Stock includes actual shares or share "units" that are earned solely by continued employment. Sixty-six percent of the Top 250 companies grant restricted stock. In general, this figure excludes companies that used shares as hire-on or one-time awards under special circumstances. Fifty-six percent of the Top 250 companies have historically granted restricted stock and 10 percent either began granting restricted stock during the latest fiscal year, or will begin to next year.

Performance Awards consist of stock-denominated performance "shares" and cash-denominated performance "units," which are earned based on performance over a multi-year period. Sixty percent of the Top 250 companies use either one or both of these grant types, with more companies using performance shares than performance units. These performance awards are the fastest growing LTI grant type with 17 percent of the Top 250 companies either began granting these types of awards during the latest fiscal year, or will begin to next year.

Grant Type (See Appendix for definition)	Percent of Companies Using Grant Type		
	2003 Report	**2004 Report**	**2005 Report**
Stock Options	**99%**	**95%**	**90%**
• Performance	13	6	6
– Vesting	*3*	*1*	*3*
– Accelerated-Vesting	*10*	*5*	*3*
• Restoration (Reload)	14	10	6*
• Premium	3	2	2
• Discount	<1	<1	<1
• Indexed	0	1	0
Restricted Stock	**49%**	**55%**	**66%**
• PARSAPs	3	4	7
Performance Shares	**26%**	**30%**	**40%**
Performance Units	**17%**	**19%**	**20%**
SARs	**1%**	**3%**	**3%**
• Tandem	<1	1	<1
• Freestanding	1	2	2
• Additive	0	0	0
Tandem Grants	**<1%**	**1%**	**0%**
Formula-Value Grants	**<1%**	**<1%**	**<1%**

* In total, 31 companies (12 percent of the Top 250 companies) granted restoration options while 17 companies explicitly stated that they will no longer grant these types of awards going forward and/or eliminated their stock option program. Therefore, we assumed that 14 companies (6 percent of the Top 250 companies) continue to grant restoration options.

STOCK OPTION DESIGN FEATURES

Overview – Among the Top 250 companies, 16 percent incorporate one or more design features into their stock option grants. The following are the principal option grant design features in use at the Top 250 companies:

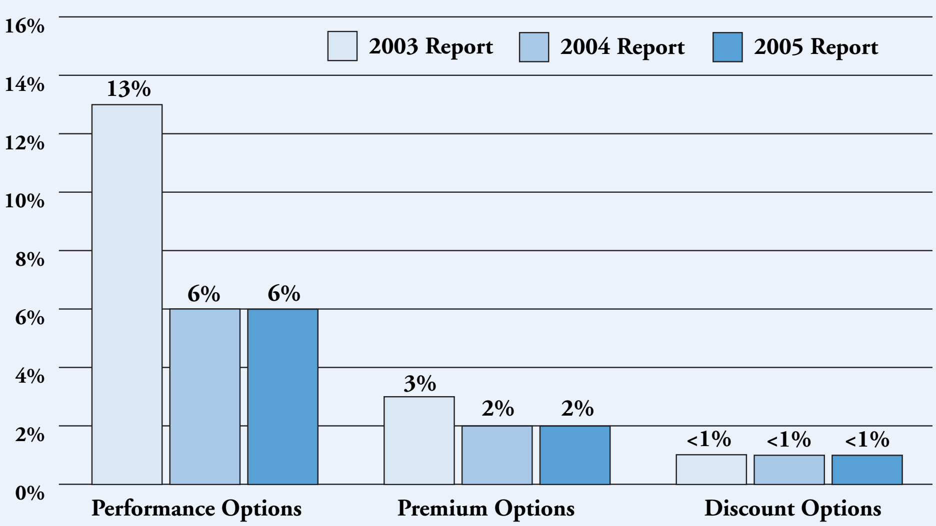
Performance Stock Options are stock options with vesting tied in some manner to specified performance criteria. Overall, performance options are used by 6 percent of Top 250 companies. Three percent of the Top 250 companies use performance criteria to *accelerate* the vesting schedule. Over the last three years, there has been a marked decrease in the use of options with performance-accelerated vesting, as highlighted in the chart on the preceding page. Presumably, this decrease is a result of the option expensing mandate in which ultimate vesting is not required to preserve fixed expense. Performance-vesting options are a variation where the stock option is forfeited if the performance objectives are not met. Three percent of the Top 250 companies use performance-vesting options, versus less than 1 percent from last year's study. These "earn it or lose it" types of options will likely increase in prevalence once option expensing is implemented since expense reversal will be permitted to the extent the performance measures are not tied to market conditions.

Restoration (Reload) Stock Options are options granted with a feature that typically allows for additional options to be granted to replace or "restore" the already-owned shares exchanged in a "stock-for-stock" exercise. They are designed to encourage management stock ownership. In total, 31 companies (12 percent of the Top 250 companies) grant restoration options while 17 companies explicitly stated that they will no longer grant these types of awards going forward and/or they eliminated their stock option program. Therefore, we assumed that 6 percent of the Top 250 companies continue to grant reloads. Restoration options will likely continue to decrease as the option expensing standard is implemented because they must be accounted for as a separate grant.

Premium and Discount Stock Options have an exercise price *above* or *below* the market price at grant, respectively. Two percent of the Top 250 companies use premium stock options, while the Gap and Network Appliance are the only companies in the Top 250 that use, or recently used, discount stock options. The use of discount stock options will likely disappear as there are adverse tax consequences for the executive under the new deferred compensation rules (Section 409A).

Indexed Stock Options are options that have an exercise price that may fluctuate above or below market value at grant, depending on the company's stock price performance relative to a specified index or the movement of the index itself. Schering-Plough is the only company in the Top 250 that uses indexed options. Indexed options are rarely used, presumably because of unfavorable accounting treatment under APB 25, complex measurement under FAS 123R, and the complicated design and administrative issues associated with them.

Executive Stock Option Features – Percent of Top 250 Companies



Performance Stock Options	***Performance Vesting –***	
	Biomet	Transocean
	Bristol-Myers Squibb	Tyco International
	Cendant	Zimmer Holdings
	Hartford Financial Services	
	Performance-Accelerated Vesting –	
	Apollo Group	Kroger
	Bristol-Myers Squibb	Lehman Brothers Holdings
	Cendant	SLM
	Electronic Data Systems	XTO Energy
Restoration Stock Options	3M	International Paper*
	Abbott Laboratories	Kellogg
	Alcoa	Masco
	Allstate*	McGraw-Hill
	Altria Group*	Mellon Financial
	American Express*	Morgan Stanley
	Burlington Northern Santa Fe*	National City
	Capital One Financial	North Fork Bancorporation
	CIGNA*	PNC Financial Services*
	Citigroup*	SLM*
	Coach*	St. Paul Travelers*
	Colgate-Palmolive*	Tribune*
	ConocoPhillips*	Valero Energy
	Corning	Waste Management*
	E.I. du Pont de Nemours*	Wells Fargo*
	Illinois Tool Works	
Premium Stock Options	Gap	Sprint
	International Business Machines	Tyco International
Discount Stock Options	Gap	Network Appliance
Indexed Stock Options	Schering-Plough	

* Specifically stated that reloads and/or options will be eliminated going forward

OTHER EXECUTIVE GRANT TYPE VARIATIONS

Overview – There are limited instances where other grant type variations (listed below) are in use at the Top 250 companies:

Stock Appreciation Rights ("SARs") are rights to receive at exercise the increase between the grant price and the market price of a share of stock. Three percent of companies in the Top 250 either currently grant SARs or anticipate granting SARs next year. Historically, SARs were rarely granted due to their unfavorable accounting treatment under APB Opinion 25. Going forward, stock-settled SARs will likely increase in use since they limit dilution and expand the life of the plan share reserve. Of those companies that grant SARs or plan to do so, the majority (seven of eight) have adopted FAS 123. Note that while different types of SARs can be granted, most companies (six of eight) grant those that are freestanding in replacement of option grants.

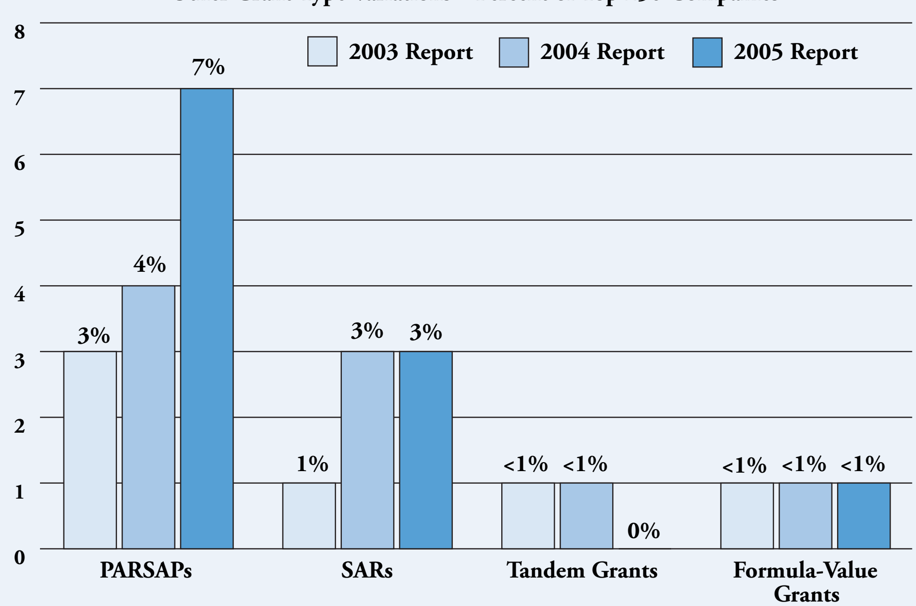
- *Tandem SARs* are granted in "tandem" with stock options, with the exercise of one canceling the other.
- *Freestanding SARs* provide for a payment equal to the appreciation on "phantom" shares, without regard to an underlying stock option.
- *Additive SARs* are rights granted in addition to a stock option.

Performance-Accelerated Restricted Stock Award Plans ("PARSAPs") represent grants of restricted stock or stock units in which time-based restrictions may be accelerated by attainment of specified performance objectives. Currently, 7 percent of the Top 250 companies grant PARSAPs, with the highest prevalence among Non-FAS 123 companies because ultimate vesting by time preserves fixed grant-date accounting treatment under the APB Option 25, the soon-to-be historical alternative accounting opinion issued in 1972.

Tandem Grants represent the simultaneous award of two grant types (other than tandem stock options/SARs) where the exercise or vesting of one grant type cancels the other. None of the Top 250 companies grant these types of awards.

Formula-Value Grants have a value based on a formula relating to financial measures, rather than the market value of company stock. Formula-value grants can be in the form of an "appreciation right" or a "full-value" grant. Johnson & Johnson is the only company in the Top 250 that makes formula-value grants, using a formula based on net asset value and a capitalized value of earnings averaged over five years. Johnson & Johnson grants these awards in addition to "plain-vanilla" stock options as part of its annual long-term incentive program.

Other Grant Type Variations – Percent of Top 250 Companies



SARs	***Freestanding -***	***Tandem -***
	Apache	Ford Motor
	Fifth Third Bancorp	Masco
	J. P. Morgan Chase	
	Marathon Oil	
	Merrill Lynch	
	Occidental Petroleum	
PARSAP	CIGNA	Mellon Financial
	Countrywide Financial	Moody's
	Dominion Resources	Regions Financial
	Duke Energy	SLM
	EMC	Staples
	First Data	Starwood Hotels & Resorts
	FirstEnergy	SunTrust Banks
	H.J. Heinz	TJX
	MBNA	
Formula-Value Grants	Johnson & Johnson	

EXECUTIVE ANNUAL INCENTIVES PAID IN STOCK

Annual incentives paid in stock or stock options seek to further align executive pay with shareholder interests and provide increased retention. Ten percent of the Top 250 companies disclose provisions for mandatory payment of annual incentives in the form of equity. This practice is most prevalent among financial services companies. Note that mandatory payment may not occur every year, and the prevalence reflects companies that have recently disclosed these types of annual incentive provisions.

In addition, some companies allow executives to voluntarily receive stock grants in lieu of earned cash compensation. These programs offer either full-value stock (often through deferral plans) or stock options, and may provide a premium or price discount to encourage participation. For instance, if the premium is 25 percent of the amount elected the executive would receive $1.25 of stock for every $1 of deferred bonus.

Following are the *typical* characteristics of mandatory payments in stock:

- **Payment in stock or stock units** typically represents a specified percent of the award payout. Twenty-four companies (10 percent) disclose the payment of at least a portion of annual incentives in shares of stock or stock units. These shares are typically subject to vesting requirements.
- **Payment in stock options** is less common than payment in stock or stock units, with only one company providing for mandatory payment in options.

MANDATORY PAYMENT OF ANNUAL INCENTIVES IN STOCK OR STOCK OPTIONS

Stock or Stock Units

American Electric Power
Bank of America
Bear Stearns
Boeing
E.I. du Pont de Nemours
EOG Resources
Equity Office Properties
Goldman Sachs Group
J. P. Morgan Chase
Lehman Brothers Holdings
Eli Lilly & Company
Marsh & McLennan
MBNA
Mellon Financial
Merrill Lynch
Morgan Stanley
National City
PNC Financial Services
Sara Lee
SLM
Starwood Hotels & Resorts
State Street
Wm. Wrigley Jr. Company

Stock Options

Yahoo!

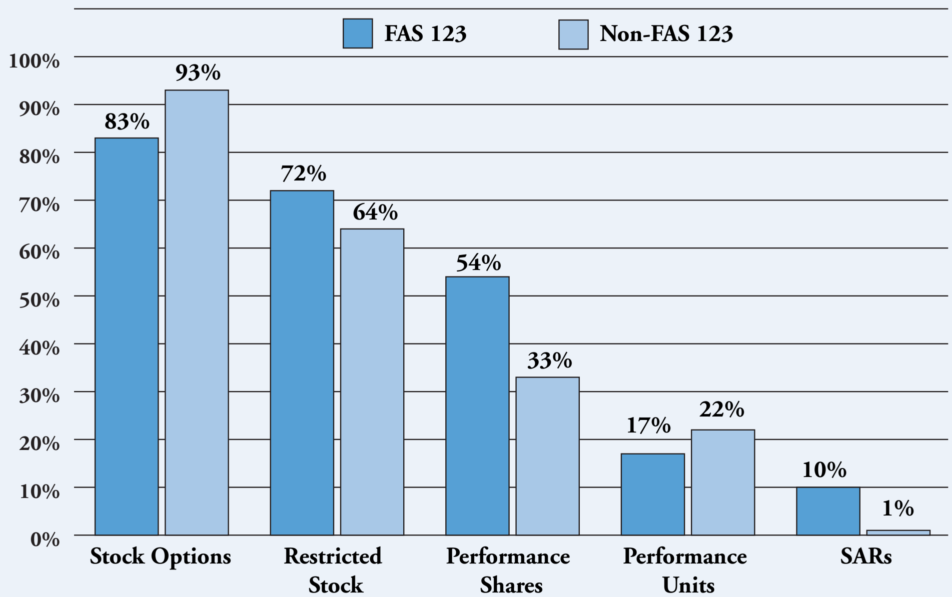
FAS 123 COMPANIES

"Early adopters" of option expensing include 76 of the Top 250 companies (30 percent), which have voluntarily implemented "fair value" accounting for stock-based grants as prescribed under FAS 123 ("FAS 123 companies"). For these companies, any stock options carry an expense ("fair value" on the date of grant) that flows through the income statement.

Overall, there is a higher prevalence of full-value awards among FAS 123 companies than among Non-FAS 123 companies. In addition, the following two trends deserve mention:

- The prevalence of stock options (83 percent), restricted stock (72 percent), and performance awards (71 percent) is converging among FAS 123 companies.
- There is increasing use of SARs at FAS 123 companies (10 percent) versus Non-FAS 123 companies (1 percent).

Grant Type Usage at FAS 123 Companies versus Non-FAS Companies



Allstate
American Express
Anadarko Petroleum
Apache
AT&T
Bank of America
Bank of New York
Bear Stearns
BellSouth
Boeing
Capital One Financial
Cendant
Chubb
Citigroup
Coca-Cola
Computer Associates International
ConocoPhillips
Consolidated Edison
Costco Wholesale
Dow Chemical
E.I. du Pont de Nemours
Emerson Electric
Entergy
ExxonMobil
Fifth Third Bancorp
Ford Motor
General Electric
General Motors
Goldman Sachs Group
Harley-Davidson
Hartford Financial Services
Home Depot
Johnson Controls
J. P. Morgan Chase
KeyCorp
Lehman Brothers Holdings
Lowes Cos
M & T Bank
Marathon Oil
Masco
Mellon Financial
Merrill Lynch
MetLife
Microsoft
Moody's
Morgan Stanley
National City
Network Appliance
Newmont Mining
Omnicom Group
Paccar
PepsiCo
PNC Financial Services
PPG Industries
Principal Financial
Progressive
Prudential Financial
Rohm & Haas
SBC Communications
Schlumberger
Simon Property Group
Sprint
St. Paul Travelers
State Street
SunTrust Banks
Target
Transocean
TXU
United Parcel Service
United Technologies
Unocal
U. S. Bancorp
Verizon Communications
Wachovia
Wal-Mart Stores
Washington Mutual

CEO LONG-TERM INCENTIVE TRENDS: VALUES AND GRANT TYPES

The following charts compare the breakdown of actual long-term incentive values delivered to the CEO for the years 2001 through 2004. The sample is generally consistent year-over-year and represents companies from the Top 250 where the CEOs have been in their roles for at least three years (171 in total).

CEO LTI VALUE AND GRANT MIX

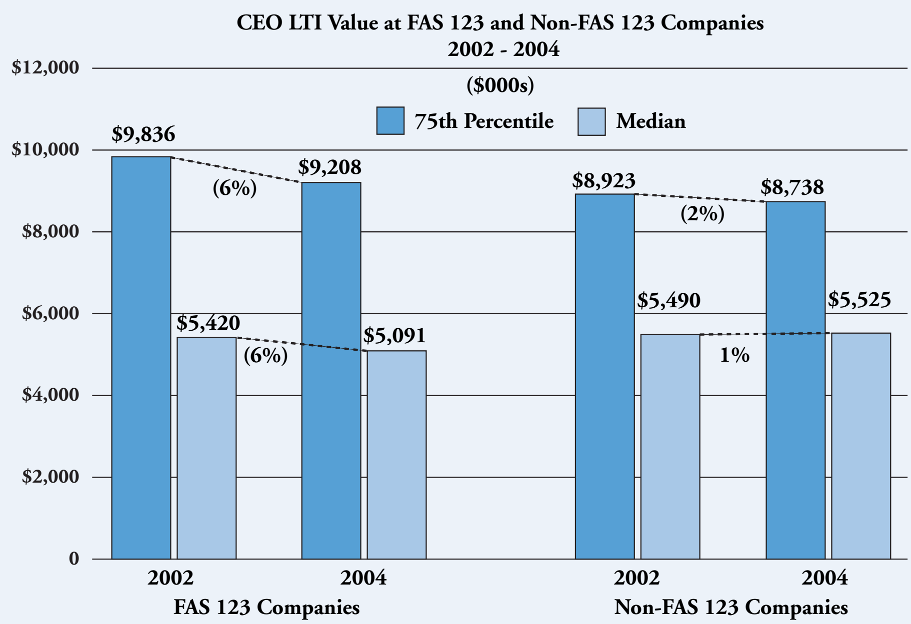
The key findings from the CEO LTI trend analysis are:

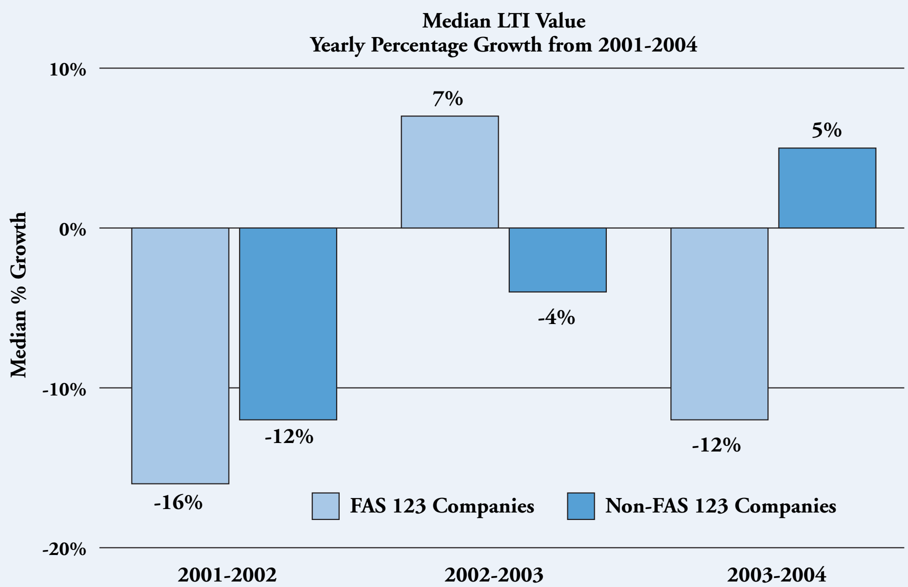
- LTI value declined slightly over the 2002 to 2004 period, except for the median value for Non-FAS 123 companies which increased by approximately 1 percent. It appears that LTI values have stabilized after values declined from 2001 to 2002.
- For the 2003 to 2004 period, median and 75th percentile LTI values were mixed for the FAS 123 and Non-FAS 123 companies:

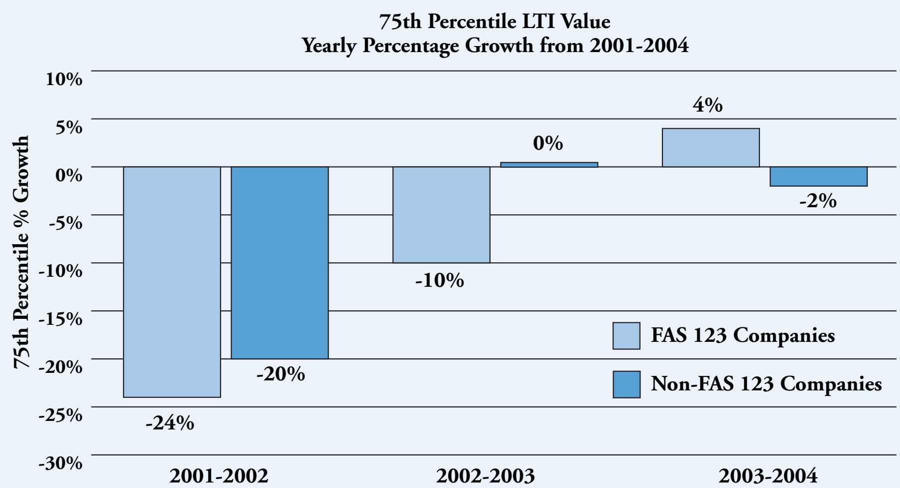
FAS 123 Companies		Non-FAS 123 Companies	
Median	75th Percentile	Median	75th Percentile
-12%	4%	5%	-2%

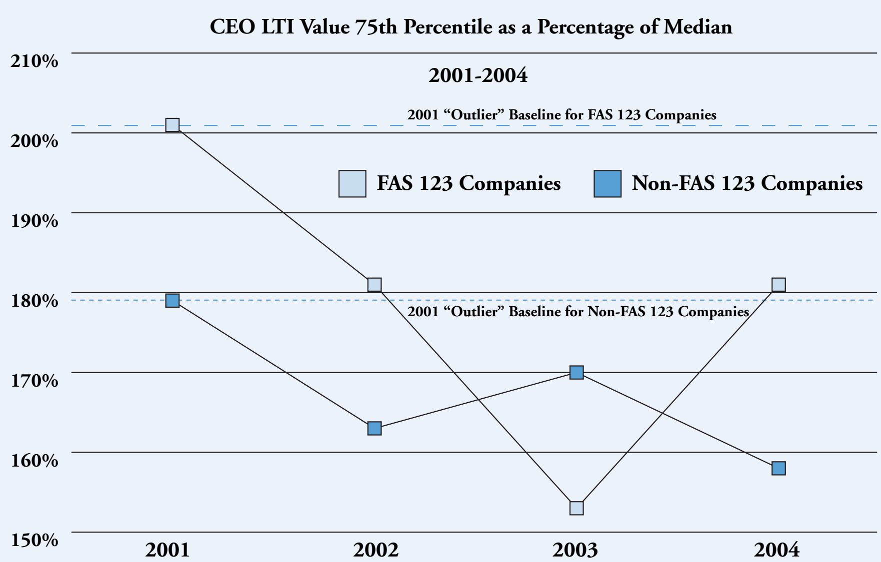
- LTI "outliers" (companies at or above the 75th percentile) have moved closer to the median since 2001 and both FAS 123 and Non-FAS 123 "outliers" moved back to the 2002 baseline, providing further evidence that grant levels may have stabilized.
- LTI grant mix continued to trend towards 50 percent stock options and 50 percent full-value awards for FAS 123 companies. Non-FAS 123 exhibited similar but less pronounced movement towards full-value awards.

Expanded results are shown on the following pages:



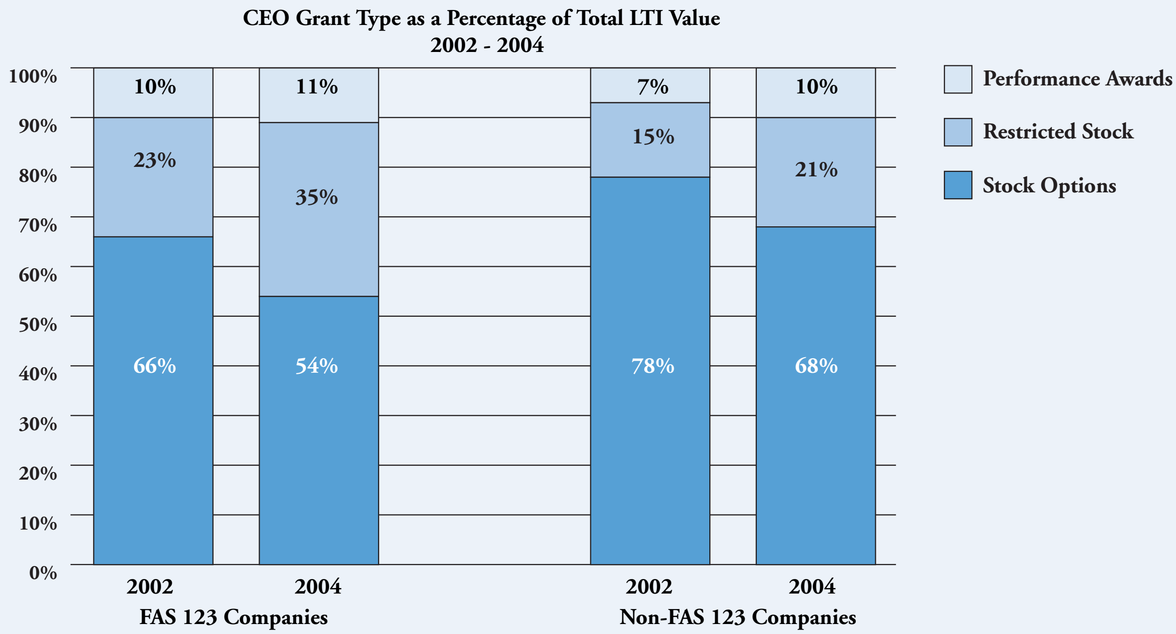

Median LTI Value
Yearly Percentage Growth from 2001-2004
Median % Growth
10%
0%
-10%
-20%
7%
5%
-4%
-16%
-12%
-12%
FAS 123 Companies
Non-FAS 123 Companies
2001-2002
2002-2003
2003-2004


75th Percentile LTI Value
Yearly Percentage Growth from 2001-2004
75th Percentile % Growth
10%
5%
0%
-5%
-10%
-15%
-20%
-25%
-30%
4%
0%
-2%
-10%
-20%
-24%
FAS 123 Companies
Non-FAS 123 Companies
2001-2002
2002-2003
2003-2004


CEO LTI Value 75th Percentile as a Percentage of Median
2001-2004
2001 "Outlier" Baseline for FAS 123 Companies
2001 "Outlier" Baseline for Non-FAS 123 Companies
FAS 123 Companies
Non-FAS 123 Companies
210%
200%
190%
180%
170%
160%
150%
2001
2002
2003
2004

CEO GRANT MIX AS PERCENTAGE OF OVERALL LTI VALUE

Similar to our findings with respect to the Top 250 companies, the mix of LTI delivered to the CEO also shifted away from stock options. The following chart compares the percentage of total long-term incentive value delivered in various grant types to CEOs in 2002 and 2004:



It is difficult to predict the future use of each grant type since there are a multitude of factors that influence program design (as well as long-term incentive strategy). Furthermore, continued emphasis on good corporate governance in executive compensation matters and share-based award expensing will shape program decision-making going forward. As we have done in our Top 250 reports for the two prior years, the following table attempts to predict future trends in executive long-term and stock-based grant practices once FAS 123(R) is universally implemented. This year, however, we also compare the current trends, using the FAS 123 companies as the leading indicators, with our expected trends. While most of our forecasts align with the current trends, the market has yet to embrace and move towards stock option variations and dividend units.

POST-FAS 123(R) ENVIRONMENT

Grant Type	Expected Future Use	Current Trend Among FAS 123 Companies	Reason
Stock Options			
• *Performance-Vesting*	Increase	Flat	Strong link between pay and performance; expense reversible if not earned *(if not market-based condition)*
• *Price-vesting*	Increase	Flat	Discounted fixed expense at grant; expense not reversible if not earned
• *Discount*	Decrease/Flat	Flat	Low cost relative to value delivered; however, carries poor shareholder optics and adverse tax consequences under new deferred compensation rules (Section 409A)
• *Dividend Units*	Increase	Flat	Total shareholder return option; dividends included in grant value vs. additional current expense
• *"Plain-Vanilla"*	Decrease	Decreasing	High cost (fair value expense vs. none now) relative to perceived employee value; not reversible if "under water"
• *Performance-Accelerated Vesting*	Decrease	Decreasing	No need for ultimate vest to preserve fixed expense
• *Restoration/reload*	Decrease	Decreasing	Continued and uncontrollable costs; each "reload" grant separately expensed
• *Incentive (ISOs)*	Decrease	Decreasing	Lack of tax deductibility increases expense by reciprocal of tax rate
• *Premium*	Flat	Flat	High cost relative to potential and "perceived" value
• *Indexed*	Flat	Flat	Strong linkage to performance; however, complicated design and administrative issues
Restricted Stock			
• *Time-Vesting*	Increase	Increasing	Provides balance in compensation program design, with greater retentive power than options and alignment with long-term shareholder interests, but weaker link to performance
• *PARSAPs*	Decrease	Decreasing	No longer necessary since performance-vesting has fixed expense
Performance Shares	Increase	Increasing	Provides performance leverage similar to options combined with the retentive power of restricted stock; expense reversible if not earned *(if goals are based on operational versus market conditions)*
Performance Units	Increase	Increasing	Strong link between pay and performance
Stock-Settled SARs	Increase	Increasing	Limits dilution and expands the life of the share reserve since fewer shares are issued upon exercise; simplifies employee administration associated with exercise *(financing or cashless exercise)*

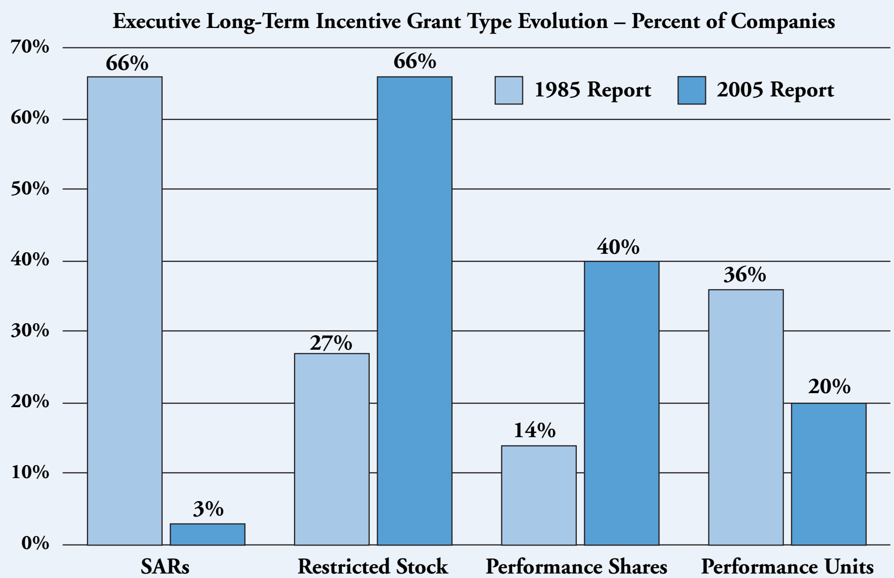
EXECUTIVE LONG-TERM INCENTIVE GRANT PRACTICE EVOLUTION

While executive long-term incentive grant practices are currently undergoing a structural shift, it is important to recognize that grant usage has continually evolved over the years. Notable comparisons between 1985 and 2005 include the following:

SARs – It may be surprising to some that, 20 years ago, SARs were widely used, second only to stock options in prevalence. Following regulatory rule changes in the mid-1990s, these grant types became nearly extinct. But under the new accounting rules, where stock-settled SARs have the same fixed grant-date expense implications as stock options, it appears SARs have begun to resurface.

RESTRICTED STOCK – Twenty years ago, restricted stock was used by only a quarter of large companies, compared to two-thirds today, due in large part to the associated accounting expense versus no expense for stock options under APB Opinion 25.

PERFORMANCE AWARDS – An interesting shift over the past two decades has been the move from cash-denominated long-term performance awards, which were relatively common in the mid-1980s, to a preference for stock-denominated awards today. Among other factors, this preference for cash-denominated awards was based on the lack of confidence in stock-based awards in the 1980s following the “stagflation” of the 1970s.



OVERVIEW – For the third year in a row, the prevalence of formal executive stock ownership policies surged in 2004, as companies continue to take steps to ensure the alignment of executives' and shareholders' long-term interests. Among the Top 250 companies, 67 percent disclosed stock ownership guidelines that encourage or require executives to own a specified amount of company stock. Given that disclosure is voluntary, the actual prevalence of ownership policies may be slightly higher than what was reported.

The basic types of ownership guidelines can be categorized as follows:

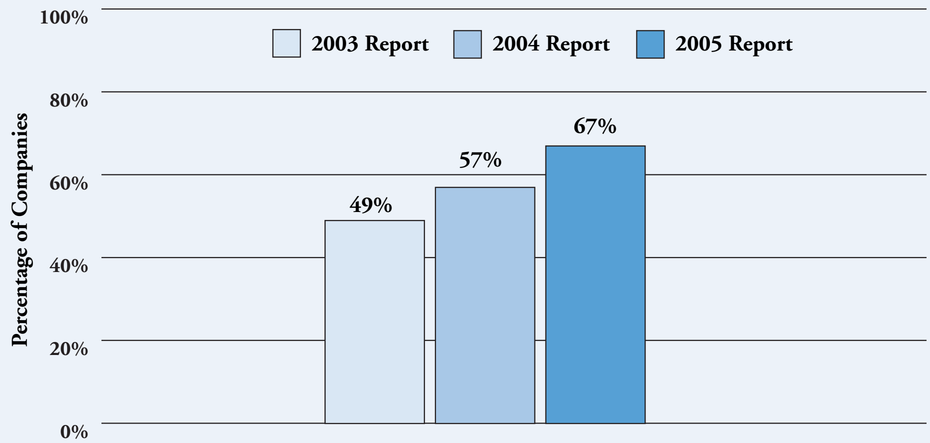
MULTIPLE OF COMPENSATION – Ownership guidelines are most commonly expressed as a multiple of an executive's compensation, with the multiple increasing with pay level. This approach is used by 64 percent of companies with guidelines. A multiple of salary is significantly more common than a multiple of total annual compensation (e.g., salary plus bonus) but for purposes of this study the two categories have been grouped together.

NUMBER OF SHARES/OTHER – Other guidelines are expressed as a number of shares or fixed dollar value and are used by 9 percent of companies with guidelines. A fixed-share approach avoids potential issues with a multiple-of-compensation approach where stock price fluctuations can dramatically alter over a short period of time whether the guidelines are met or not.

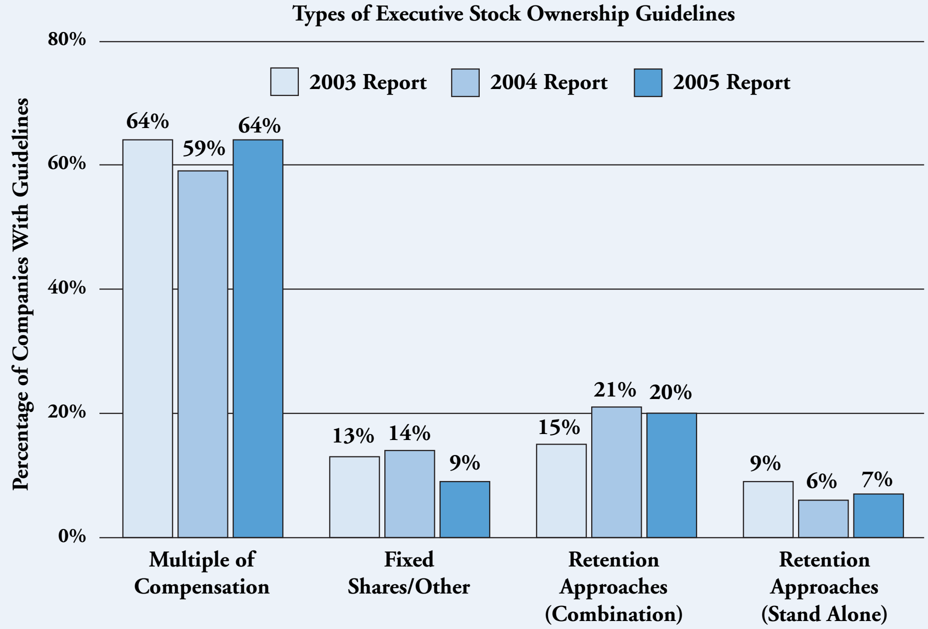
RETENTION APPROACHES take two general forms: retention ratios or holding periods. Retention ratios require executives to retain a certain percentage of "profit shares" from stock options that are exercised or other stock awards that are earned. (Profit shares are the shares remaining after payment of the option exercise price and taxes owed at exercise, vesting of restricted stock, or earnout of performance shares.) Under the holding-period approach, shares obtained from equity awards must be held for some specific period of time. In total, retention approaches are used by 27 percent of companies with guidelines. Some companies use a retention ratio or holding period in addition to other types of guidelines. For example, a company using a multiple-of-salary guideline may require executives to retain 100 percent of option profit shares for one year after exercise. Alternatively, some companies apply a retention ratio until ownership requirements are met. Twenty percent of companies use a retention approach in combination with another ownership guideline, while 7 percent use a retention approach as a standalone guideline.

The following exhibits show the prevalence of ownership guidelines at the Top 250 companies, as well as the types of approaches used. Three percent of companies with guidelines did not disclose the type of ownership guidelines used.

Prevalence of Executive Stock Ownership Guidelines



Types of Executive Stock Ownership Guidelines



SUMMARY OF GRANT USAGE BY COMPANY

	Adopted FAS 123	EXECUTIVE LONG-TERM INCENTIVE GRANTS: Appreciation		Full Value			
		Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares	Performance Units
3M		●					●
Abbott Laboratories		●		●			
ACE Limited		●		●			
Adobe Systems		●					
AES Corporation		●				▲	●
AETNA		●				❍	▲
AFLAC		●					
Agilent Technologies		●				▲	
Air Products & Chemicals		●		●		●	
Alcoa		●		▲		▲	
Allstate	X	●		●			●
ALLTEL		●		▲			●
Altria Group		❍		●			●
American Electric Power		❍				●	
American Express	X	●		●			●
Amgen		●					▲
Anadarko Petroleum	X	●		●		▲	
Analog Devices		●					
Anheuser-Busch Companies		●					
Apache	X	▲	●	●		●	
Apollo Group		●					
Apple Computer		●		●			
Applied Materials		●					
Archer Daniels Midland		●		●			
AT&T	X	❍		●		●	
Automatic Data Processing		●		●			
Avon Products		●		●			●
Baker Hughes		●		●		●	
Bank of America	X	●		●			
Bank of New York	X	●		●		●	
Baxter International		●		●			
BB&T		●					●
Bear Stearns	X	●		●			
Becton Dickinson		●		▲		▲	
Bed Bath & Beyond		●		▲		▲	
BellSouth	X	❍		●		●	
Best Buy		●				●	
Biogen Idec		●		●			
Biomet		●					
Boeing	X			●		●	
Boston Scientific		●					
Bristol-Myers Squibb		●		●		●	

● = Continuing ▲ = New or prospective grant type ❍ = Dropped

SUMMARY OF GRANT USAGE BY COMPANY

		EXECUTIVE LONG-TERM INCENTIVE GRANTS					
		Appreciation		Full Value			
	Adopted FAS 123	Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares	Performance Units
Burlington Northern Santa Fe		●		●		●	
Burlington Resources		●		●		●	
Campbell Soup		●		●		❍	
Capital One Financial	X	●		●			
Cardinal Health		●		▲			
Caremark Rx				●			
Carnival		●		●			
Caterpillar		●		▲			●
Cendant	X	●		●			▲
ChevronTexaco		●				●	
Chubb	X	❍		●		●	
CIGNA		●		●	●		●
Cisco Systems		●					
Citigroup	X	●		●			
Clear Channel Communications		●		●			
Coach		●		●			
Coca-Cola	X	●				▲	●
Colgate-Palmolive		●		●		●	●
Comcast		●		▲			
Computer Associates International	X	●				●	
ConAgra Foods				●		●	●
ConocoPhillips	X	●		❍		●	
Consolidated Edison	X	●		●		▲	
Corning		●		❍		▲	
Costco Wholesale	X	●					
Countrywide Financial		●		●	▲		
CVS		●		▲			●
Danaher		●		▲		▲	
Deere		●		●			●
Dell		●					●
Devon Energy		●		●			
Walt Disney Company		●		●		●	
Dominion Resources		●		●	▲		
Dow Chemical	X	●		●		●	
E.I. du Pont de Nemours	X	●		▲			▲
Duke Energy		❍		●	●	●	
EMC		●		●	●		
Eaton		●		●		●	
eBay		●					
Edison International		●				●	
Electronic Arts		●					
Electronic Data Systems		●		●			▲

● = Continuing ▲ = New or prospective grant type ❍ = Dropped

SUMMARY OF GRANT USAGE BY COMPANY

● = Continuing ▲ = New or prospective grant type ❍ = Dropped

		EXECUTIVE LONG-TERM INCENTIVE GRANTS					
		Appreciation		Full Value			
	Adopted FAS 123	Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares	Performance Units
Emerson Electric	X	●		●		●	
Entergy	X	●				●	
EOG Resources		●		●			
Equity Office Properties		●		●			
Exelon		●		❍		▲	
ExxonMobil	X			●			●
FedEx		●		●			●
Fifth Third Bancorp	X	❍	▲	●		●	
First Data		●			●		●
FirstEnergy		❍			▲	●	
Ford Motor	X	●	●	●		●	
Forest Laboratories		●					
Fortune Brands		●				●	
FPL Group		●		●		●	
Franklin Resources		●		●		●	
Gannett		●		●			
Gap		●		▲			
General Dynamics		●		●			
General Electric	X	●	❍	●		▲	●
General Mills		●		●			
General Motors	X	●				●	
Genzyme		●					
Gilead Sciences		●					
Gillette		●					
Golden West Financial		●					
Goldman Sachs Group	X			●			
Guidant		●		●			
Halliburton		●		●			●
Harley-Davidson	X	●					
Hartford Financial Services	X	●		●		●	
HCA		●		●			
H.J. Heinz		●		●	●		▲
Hershey Foods		●		●		●	
Hewlett-Packard		●		●			●
Home Depot	X	●		●			●
Honeywell International		●		●			▲
Illinois Tool Works		●		●			
Ingersoll-Rand		●		●			
Intel		●					
International Business Machines		●		●		●	
International Paper		❍		●		●	
Johnson & Johnson		●					

SUMMARY OF GRANT USAGE BY COMPANY

	Adopted FAS 123	EXECUTIVE LONG-TERM INCENTIVE GRANTS — Appreciation: Stock Options	Appreciation: SARs	Full Value: Restricted Stock	Full Value: PARSAPs	Full Value: Performance Shares	Full Value: Performance Units
Johnson Controls	X	●		●			●
J. P. Morgan Chase	X	●	●	●			
Kellogg		●		●			●
Kerr-Mcgee		●		●			●
KeyCorp	X	●		●	❍	▲	
Kimberly-Clark		●		●		▲	
Kohl's		●		▲			
Kroger		●		●			
Lehman Brothers Holdings	X	●		●			
Eli Lilly & Company		●		●			
Linear Technology		●		▲			
Lockheed Martin		●		▲			●
Loews Corp		●					
Lowes Cos	X	●		●			
Lucent Technologies		●				▲	❍
M & T Bank	X	●					
Marathon Oil	X	●	●	●		●	
Marriott International		●		●			
Marsh & McLennan		●		●		▲	
Masco	X	●	●	●			
Maxim Integrated Products		●					
MBNA		❍		●	▲		
McDonald's		●		●			▲
McGraw-Hill		●				●	
McKesson		●		●			
Medco Health Solutions		●		▲			
Medtronic		●		●		●	
Mellon Financial	X	●		●	●		
Merck		●		▲		▲	
Merrill Lynch	X	●	▲	●			
MetLife	X	●				▲	❍
Microsoft	X	❍		▲		▲	
Monsanto Company		●		▲		●	
Moody's	X	●		▲	▲		
Morgan Stanley	X	●		●			
Motorola		●		●			●
National City	X	●		●			●
Network Appliance	X	●		●			
Newmont Mining	X	●		●			❍
Nike		●				●	●
Norfolk Southern		●		●		●	●
North Fork Bancorporation		●		●			

● = Continuing ▲ = New or prospective grant type ❍ = Dropped

SUMMARY OF GRANT USAGE BY COMPANY

		EXECUTIVE LONG-TERM INCENTIVE GRANTS					
		Appreciation		Full Value			
	Adopted FAS 123	Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares	Performance Units
● = Continuing ▲ = New or prospective grant type ❍ = Dropped							
Northrop Grumman		●				●	
Occidental Petroleum		●	▲	●		●	
Omnicom Group	X	●		●		●	
Oracle		●					
Paccar	X	●					●
Paychex		●					
J. C. Penney		●				▲	
PepsiCo	X	●				●	
Pfizer		●		●		●	
PG&E		●		●		●	❍
Pitney Bowes		●		●			●
PNC Financial Services	X	●		●		●	
PPG Industries	X	●		▲		●	
Praxair		●					
Principal Financial	X	●		▲			
Procter & Gamble		●		▲		●	●
Progress Energy		❍		●		●	
Progressive	X			●		●	
Prudential Financial	X	●				●	
Public Service Enterprise Group		●		▲		▲	
QUALCOMM		●					
Raytheon		❍		●		▲	
Regions Financial		●		●	●		
Reynolds American						●	▲
Rockwell Automation		●		●			
Rohm & Haas	X	●		●		▲	❍
Sara Lee		❍		●		▲	
SBC Communications	X	❍		❍		●	
Schering-Plough		●		●		▲	▲
Schlumberger	X	●					
(Charles) Schwab		●		●			▲
Sears, Roebuck		●		●		●	
Simon Property Group	X					●	
SLM		●		●	●		
Southern Co		●					●
Southwest Airlines		●					
Sprint	X	●		●			
St. Jude Medical		●		●			
St. Paul Travelers	X	●		●			
Staples		●		●	●		
Starbucks		●					
Starwood Hotels & Resorts Worldwide		●		●	●		

SUMMARY OF GRANT USAGE BY COMPANY

		Executive Long-Term Incentive Grants					
		Appreciation		Full Value			
Company	Adopted FAS 123	Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares	Performance Units
State Street	X	●				●	●
Stryker		●					
Sun Microsystems		●					
SunTrust Banks	X	●		●	●		●
Symantec		●					
SYSCO		●					▲
Target	X	●				●	
Texas Instruments		●		▲			
Textron		●		●		▲	❍
Time Warner		●		●			
TJX		●		●	●		●
Transocean	X	●				●	
Tribune		●					
TXU	X					▲	❍
Tyco International		●		●			
Union Pacific		●		●		❍	
United Parcel Service	X	●		●		●	
United Technologies	X	●					
UnitedHealth		●					●
Unocal	X	●		●		●	
U. S. Bancorp	X	●		❍			
Valero Energy		●		●		●	
Verizon Communications	X	❍		●		●	
Viacom		●				▲	
Wachovia	X	●		●			
Wal-Mart Stores	X	●		●		▲	
Walgreen		●		●			
Washington Mutual	X	●		▲		●	
Waste Management		●		▲			
Wellpoint		●		●			
Wells Fargo		●					
Weyerhaeuser		●					
Wm. Wrigley Jr. Company		●		▲		●	
Wyeth		●				●	
Xerox		❍		●		▲	
Xilinx		●					
XTO Energy		●				❍	
Yahoo!		●		●		●	
Yum! Brands		●					
Zimmer Holdings		●					

● = Continuing ▲ = New or prospective grant type ❍ = Dropped

GRANT TYPE CLASSIFICATIONS

For purposes of this report, grant types are classified according to how value is delivered to the recipient, differentiating between "appreciation" grants and "full-value" grants, as summarized below:

Appreciation Grants:

- Stock Options
- Stock Appreciation Rights (SARs)

Full-Value Grants:

- Restricted Stock
- Performance Shares
- Performance Units

Appreciation grants typically have no intrinsic value at the time of grant and depend upon the appreciation of a company's stock price to deliver value to the recipient. Full-value grants, on the other hand, have value at the time of grant and may either increase or decrease in value depending on company performance and/or subsequent changes in stock price. Formula-value grants use financial measures instead of stock price to determine value and may be either an appreciation grant or a full-value grant.

Definitions for each of the above grant types, as well as other grant type variations, appear on the following pages of this *Appendix*.

APPRECIATION GRANTS

Stock Options are rights to purchase shares of company stock at a specified price over a stated period, usually ten years or less. Typically, the option price is 100% of market value at the time of grant and vest by continued service, although variations of this "plain-vanilla" type option are used in practice:

- **Performance-Accelerated Stock Options ("PASOs")** are options that have a set service-vesting schedule, but may be exercised earlier if specified performance criteria are met, e.g., attaining specific stock price goals. Options with performance-accelerated vesting provisions eventually become exercisable later in their option term by continued service regardless of attaining the performance goals.
- **Performance-Vesting Stock Options** are considered to have "vesting with teeth" because the options are forfeited if performance criteria are not met prior to the expiration of the option term.
- **Premium Stock Options** are options that have an exercise price *above* market value at the time of grant.
- **Discount Stock Options** are options that have an exercise price *below* market value at the time of grant.
- **Indexed Stock Options** are options that have an exercise price that may fluctuate above or below market value at grant, depending on the company's stock price performance relative to a specified index or based on the movement of the index itself.

Stock Appreciation Rights ("SARs") are rights to receive the increase between the grant price and market price of the company stock, which can be settled in stock or cash. This survey covers three types of market-based SARs:

- **Tandem SARs** are granted "in tandem" with stock options with the exercise of the SAR canceling the option, and vice versa.
- **Freestanding SARs** are rights to receive the gain on a "phantom" stock option. Freestanding SARs are granted independently from stock options and, therefore, the exercise of the SAR does not cancel any outstanding stock options.
- **Additive SARs** are rights granted in addition to a stock option. In most cases, the exercise of the underlying option triggers the SAR payment and the two are paid simultaneously (unlike tandem SARs where the exercise of the stock option will cancel the SAR payment and vice versa). Additive SARs are typically used to offset income taxes on the related stock option gain, as well as the tax on the SAR payment.

FULL-VALUE GRANTS

Restricted Stock consists of grants of actual shares of stock or stock "units" (commonly referred to as "RSUs") that are subject to transfer restrictions and risk of forfeiture until vested by continued employment. Dividends or dividend equivalents are typically paid during the restriction period, on either a current or deferred basis. If deferred, the dividends or equivalents are often converted into additional restricted shares, subject to the same restrictions and risk of forfeiture as the underlying award.

- **Performance-Accelerated Restricted Stock Award Plans ("PARSAPs")**, also known as time-accelerated restricted stock award plans ("TARSAPs"), are grants of restricted stock that may vest early upon attainment of specified performance objectives. As with PASOs, PARSAPs eventually vest based on continued service alone.

Performance Shares are grants of actual shares of stock or stock "units" whose payment is contingent on performance as measured against predetermined objectives over a multi-year measurement period, and differ from performance units in that the value paid fluctuates with stock price changes, as well as performance against objectives. The payout may be settled in cash or stock.

Performance Units are grants of cash or dollar-denominated units whose payment or value is contingent on performance against predetermined objectives over a multi-year measurement period. Actual payouts may be in cash or stock.

FORMULA-VALUE GRANTS

Formula-Value Grants are rights to receive value based on a formula using financial measures rather than the market value of company stock, e.g., book value per share. Formula-value grants can be structured as either "appreciation" grants, based on the appreciation in value over the starting value, or as "full-value" grants.

COMPANY PROFILE

Frederic W. Cook & Co., Inc. is an independent consulting firm specializing in executive and director compensation and related corporate governance matters. Formed in 1973, our firm has served more than 1,700 corporations, including 40 percent of the current Fortune 200 during the past two years, in a wide variety of industries from our offices in New York, Chicago, and Los Angeles. Our primary focus is on performance-based compensation programs that help companies attract and retain business leaders, motivate and reward them for improved performance, and align their interests with shareholders. Our range of consulting services includes:

- Annual Incentive Plans
- Change-in-Control and Severance
- Compensation Committee Advisor
- Competitive Assessment
- Corporate Governance Matters
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- Strategic Incentives
- Total Compensation Reviews

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