Frederic W. Cook & Co., Inc.

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Changes in Change-in-Control Practices

Our research found that the largest corporations in the United States have begun to restrict their change-in-control arrangements in response to corporate governance reform pressures from shareholder activist groups. The most significant changes made by companies over the past three years were: 11% eliminated the excise tax gross-up altogether and 8% moved from a full gross-up to a modified gross-up; 9% moved from single-trigger vesting to double-trigger vesting of their equity awards; 8% raised the acquisition threshold percentage, typically to 30%; and 7% reduced the severance multiples for the CEO and other proxy officers, typically from 3X to 2X.

Executive Summary

The objectives behind change-in-control ("CIC") arrangements are to motivate executives to continue to work in the best interests of the company and its shareholders and to mitigate potential anxiety an executive may have regarding his or her future employment with the company due to a CIC. Companies enter into these arrangements to ensure continuity of management during mergers and acquisitions and as a way to attract and retain highly valued executives.

The recent focus on corporate governance reform in the wake of the financial crisis has drawn attention to CIC arrangements and the costs associated with providing executives with these protections. In addition, shareholder activist groups have brought forth proposals in annual proxy statements seeking to limit payments under CIC severance programs, and the RiskMetrics Group ("RMG") has designated certain features of CIC arrangements as constituting "poor pay practices" that may trigger negative or withhold vote recommendations on re-election of corporate directors (especially members of the compensation committee). It is with this background that we analyzed how companies have made changes to their CIC arrangements in response to the corporate governance reform pressures. The sample of companies reviewed were the 125 largest companies from the 2009 Fortune 500 list.

Eighty-eight companies (70% of the sample) provide special CIC severance arrangements to their named executive officers ("NEOs"), and of these companies fifty (57%) made changes to their CIC arrangements. We observed the following changes made by companies with special CIC severance arrangements during the past three years:

- Twenty-three percent modified their excise tax gross-up treatment. Eleven percent eliminated the excise tax gross-up altogether and eight percent moved from a full gross-up to a modified gross-up.

- Sixteen percent modified their treatment of equity vesting acceleration on CIC. Nine percent moved from single-trigger vesting to double-trigger vesting.

- Fourteen percent modified their definition of CIC. Eight percent raised the acquisition threshold percentage, typically to 30%.

- Nine percent modified their severance multiples in the CIC cash severance formula. Seven percent reduced the multiples for the CEO and other NEOs, typically from 3X to 2X.

- Nine percent modified how bonus is defined in their CIC cash severance formulas. Five percent moved to defining it exclusively as the target bonus from using multiple criteria.

- Seventeen percent made miscellaneous other changes to their CIC arrangements. The most prevalent changes were removal of "walkaway" rights (7%) and removing or capping perquisite/outplacement/financial planning benefits (5%).

The following pages of this letter discuss these key findings in greater detail.

Introduction

Background & Overview

This letter presents information on changes in change in control ("CIC") practices for named executive officers ("NEOs") of the 125 largest publicly-traded companies from the 2009 Fortune 500 list. Selection of these companies was based on their revenues for fiscal years ended on or before January 31, 2009. A complete list of the companies and summary financial data can be found on the last page of this letter.

The changes presented in this letter were implemented over the prior three years, i.e., between 2006 and 2009. Our research is based on proxy and Form 8-K disclosures filed between January 1, 2007 and July 31, 2009. We focused on this time period because the enhanced proxy disclosure rules that were in effect during this time provided the data necessary for our research.

Note that we counted companies as having special CIC arrangements if they offered their NEOs enhanced cash severance on a CIC-related termination. Companies that only offered equity vesting acceleration on CIC or no special CIC cash severance outside of their regular severance arrangements were not counted as part of this sample.

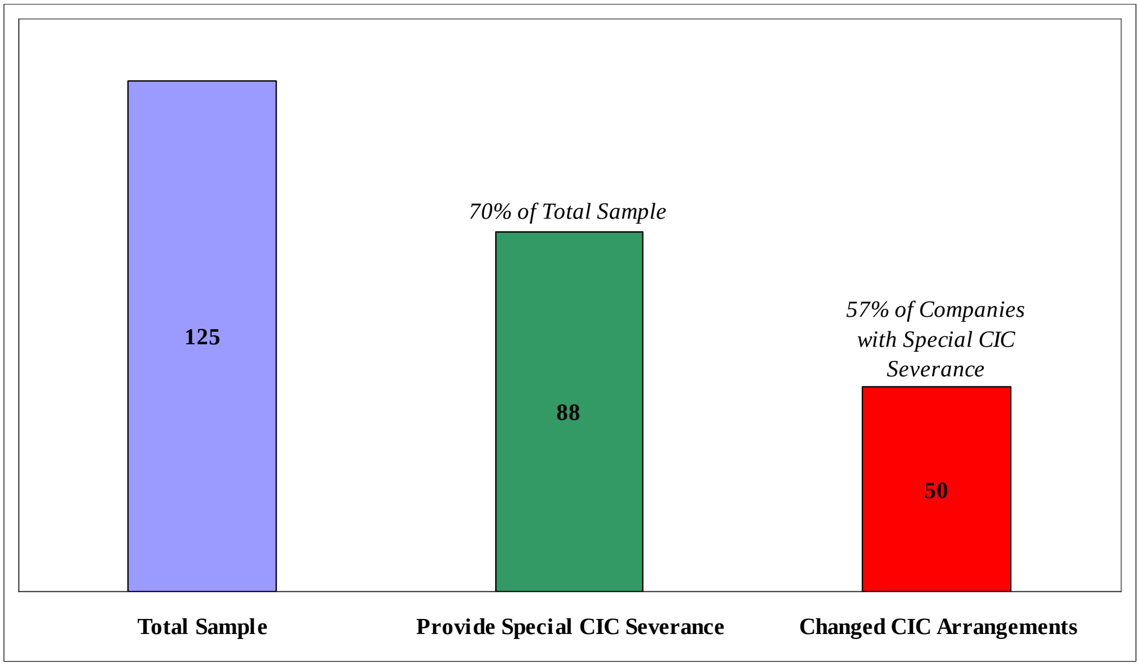
Survey Scope

The following topics are covered in this letter:

- Prevalence of special CIC severance arrangements among the sample companies, and changes made to these arrangements with regard to the following:
    - Excise tax gross-up
    - Equity vesting acceleration
    - CIC definition
    - Severance multiple in cash severance formula
    - Bonus definition in cash severance formula
    - Other (e.g., walkaway rights, perquisite continuation, pension enhancements, etc.)

Prevalence

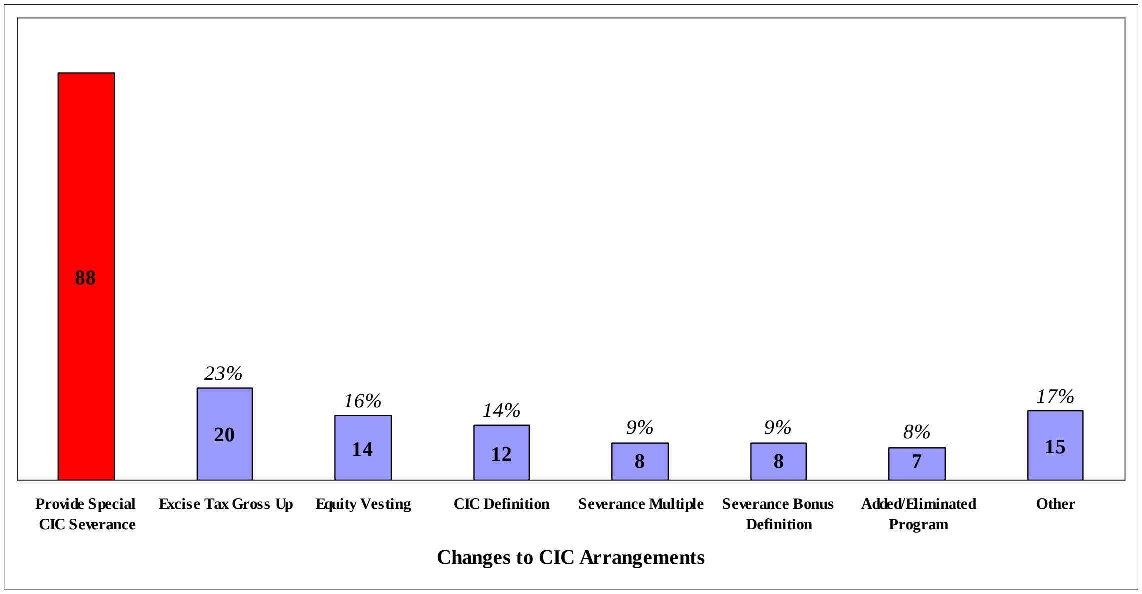
The graph below summarizes the prevalence of special CIC severance arrangements among the sample companies and the number of companies that changed their CIC arrangements over the prior three years:



Among the 88 companies that provided their NEOs special CIC severance arrangements over the prior three years, four companies added such arrangements and three eliminated their arrangements. Note that we counted as active the CIC arrangements frozen due to the restrictions applicable to financial institutions receiving assistance under the Troubled Asset Relief Program ("TARP") on the assumption that the affected companies will, at some point, pay back their TARP assistance and no longer be subject to the restrictions.

Changes Made to CIC Arrangements

The graph below summarizes the changes made by companies with special CIC severance arrangements over the prior three years. The number within the column represents the number of companies that made the change and the percentage at the top of the column represents this as a percent of the total number of companies that provide special CIC severance.



Excise Tax Gross-Up

Background

Under Section 4999 of the Internal Revenue Code, an excise tax must be paid by an individual if total "parachute payments" made in connection with a CIC exceed the safe harbor limit, which is $1.00 less than 3X the individual's "base amount." Base amount is defined as the average W-2 compensation from the company for the five years preceding the year in which the CIC occurs. The excise tax to the individual is equal to 20 percent of all "parachute payments" in excess of 1X the "base amount" and the company loses the corresponding tax deduction for this "excess parachute payment."

Companies address the issue in one of the following ways:

Provide full tax gross-up – company pays the individual's excise and related income taxes in an effort to offset the excise tax and keep the individual whole. Note that these payments are deemed "excess parachute payments" as well, which requires the company to gross-up the gross-up payment. In so doing, the company provides the individual with payments such that the individual receives on an after-tax basis an amount equal to the amount the individual would have received in the absence of the imposition of the excise taxes.

Provide modified tax gross-up – company pays the excise tax only if the payments exceed the safe harbor by a certain amount (e.g., 110% or $50,000). If not, payments are cut back to the safe harbor.

Limit payments to safe harbor – company cuts back all payments to the safe harbor limit so that no excise tax is imposed on the individual under any circumstance.

Provide best-net payment – company cuts back payments to the safe harbor limit only if the individual would receive a greater after-tax benefit than if the excise tax were paid by the individual on the excess parachute payments.

Provide no tax gross-up – company requires executive to pay excise tax if payments exceed the safe harbor.

Findings

The most prevalent change made by companies with special CIC severance arrangements was modification of the excise tax gross-up treatment (23%). As illustrated in the table below, most of the companies that made such a change eliminated the excise tax gross-up altogether or moved to a modified excise tax gross-up from a full gross-up:

Change to Excise Tax Gross-Up Treatment	Number of Companies	% of Companies With Special CIC Severance (88)
Eliminated the Excise Tax Gross-Up	10	11%
Moved from a full excise tax gross-up to a modified gross-up	7	8%
Miscellaneous (two companies went from a pure cutback to a best-net approach and one company introduced the best-net approach)	3	3%
Total	**20**	**23%**

Note that providing an excise tax gross-up (including a modified gross-up) was added for 2009 to RiskMetrics Group's ("RMG") list of "poor pay practices" for new or materially amended agreements. Under their 2009 policy, RMG may recommend to shareholders that votes be withheld from (or be voted against) compensation committee members (and potentially the entire board of directors) if new or materially amended agreements include any type of excise tax gross-up.

Equity Vesting

Background

Equity vesting acceleration can be designed as either a single-trigger or double-trigger event:

Single-Trigger – equity vesting acceleration occurs upon the occurrence of a CIC. The individual does not need to be terminated to receive the equity vesting acceleration.

Double-Trigger – equity vesting acceleration occurs upon both the occurrence of a CIC ("first trigger") and a qualifying termination of the individual's employment with the company ("second trigger") within the CIC protection period (the period following the CIC in which the individual is entitled to receive special severance payments if employment is terminated by the company without cause and, if applicable, by the individual for "good reason"). Thus, the individual must actually lose his or her job to receive equity vesting acceleration.

Findings

Sixteen percent of companies with special CIC severance made modifications to their equity vesting on CIC. The most prevalent change was moving from single-trigger vesting to double-trigger vesting:

Change to Vesting of Equity Awards	Number of Companies	% of Companies With Special CIC Severance (88)
Moved from single-trigger vesting of equity award to double-trigger	8	9%
Moved from full payout of performance shares to pro rata payout	2	2%
Limited payout of performance shares to target	2	2%
Miscellaneous (one company eliminated "good reason" termination from the double trigger-definition, and one company limited perfomance share payout from 100% of target to 80% of target)	2	2%
Total	**14**	**16%**

Note that two companies, PepsiCo and Morgan Stanley, which are not part of the sample since they do not have special CIC severance arrangements, also moved from single-trigger to double-trigger vesting over the prior three years.

Single-trigger vesting is generally viewed as being inconsistent with investor preferences and has become an important corporate governance issue. Double-trigger vesting in new or amended employment and CIC severance agreements was added for 2009 to RMG's list of "good pay practices" for new or materially amended agreements.

CIC Definition

Background

CIC definitions typically include (i) an acquisition threshold percentage (i.e., acquisition of a certain percentage of the company's shares by one person or group) that triggers a CIC and (ii) a merger exception percentage (i.e., the percentage of voting securities of the merged entity which company shareholders must own following the merger in order for the CIC not to be triggered).

Findings

Fourteen percent of companies with special CIC severance made modifications to their definition of change in control. Most of the changes involved increasing the acquisition threshold percentage:

Change to Definition of Change in Control	Number of Companies	% of Companies With Special CIC Severance (88)
Raised the acquisition threshold percentage	7	8%
Reduced the acquisition threshold percentage	2	2%
Introduced clarity to the CIC definition (including language on consummation of the transaction)	3	3%
Total	**12**	**14%**

Note that three of the seven companies that raised their acquisition threshold percentage concurrently reduced the merger exception percentage in their CIC definition. Note that a higher acquisition percentage and a lower merger exception percentage are consistent with best practice. The typical increase of the acquisition threshold percentage was to 30% and the typical decrease of the merger exception percentage was to 50%.

Severance Multiple

CIC cash severance formulas are typically expressed as a multiple of salary and bonus. Nine percent of companies with special CIC severance made modifications to the severance multiples in their cash severance formulas. Most of these companies reduced their severance multiples for both their CEOs and other NEOs:

Changes to CIC Severance Multiple	Number of Companies	% of Companies With Special CIC Severance (88)
Reduced CIC severance multiple	6	7%
Miscellaneous (one company increased the CIC severance multiples for NEOs from 2X to 3X, and one company replaced severance multiples with specified fixed severance amounts for NEOs)	2	2%
Total	**8**	**9%**

Note that of the six companies that reduced their CIC severance multiples, three reduced their severance multiples from 3X to 2X for the CEO and other NEOs. Reduction in the multiple is consistent with emerging trends in our experience.

Severance Bonus Definition

Background

Bonus in the CIC cash severance formula can be defined in a number of different ways, including but not limited to, the following:

Higher of – executive receives the greater of two or more criteria, usually the target bonus in the year of termination or the average bonus over a prior number of years

Average – executive receives the average bonus paid over a prior number of years (e.g., three years)

Target – executive receives the target bonus for the year of termination

Findings

Nine percent of companies with special CIC severance made modifications to how bonuses are defined in their CIC severance formulas. Half of these companies moved to exclusively using target bonus in their formulas instead of "higher of" measures of bonus:

Change to Severance Bonus Definition	Number of Companies	% of Companies With Special CIC Severance (88)
Moved to target bonus from greater of target, multi-year average or prior year actual bonus	4	5%
Moved to multi-year average bonus from greater of target, multi-year average or prior year actual bonus	2	2%
Eliminated long-term incentive awards from severance formula	2	2%
Moved to target bonus from maximum bonus	1	1%
Total	**8**	**9%**

Note that the totals do not add down because one company made two changes to its severance bonus definition, i.e., took out long-term cash from the severance formula and moved to a multi-year average bonus definition. In our experience, there has been an emerging trend to eliminate long-term incentive awards from the CIC severance bonus definition (however, note that it was rare to include it in the first place).

Other Changes:

Background

Definition of terms:

Protection period – the period following the CIC in which the individual is entitled to receive CIC cash severance payments if employment is terminated by the company without cause or by the individual with "good reason."

"Walkaway window" – allows the individual to terminate employment voluntarily for any reason during a specified period following a CIC (e.g., in the 13th month following the date of the change of control) and receive CIC severance.

Findings

Seventeen percent of companies with special CIC severance made modifications to their arrangements that could not be classified in the above categories. The most prevalent change in this "other" category was removal of the "walkaway" right:

Other Changes	Number of Companies	% of Companies With Special CIC Severance (88)
Removed "walkaway" right	6	7%
Removed or capped perquisite/outplacement/financial planning benefits	4	5%
Eliminated pension enhancements	3	3%
Shortened the CIC termination protection period	3	3%
Based prorata bonus payout on actual performance	2	2%
Shortened health & welfare benefits continuation period	2	2%
Total	**15**	**17%**

Note that the totals do not add down because some companies made multiple changes. A walkaway right in new or amended CIC severance arrangements was added for 2009 to RMG's list of "poor pay practices" for new or materially amended agreements that may result in an RMG recommendation to shareholders that votes be withheld from (or be voted against) compensation committee members (and potentially the entire board of directors). Pension enhancements are inconsistent with emerging best practice due to the sensitivity of the size of additional benefits relative to cash severance.

Conclusions:

We anticipate the trends highlighted in this survey to continue in response to investor concerns, RMG policy and potentially a non-binding vote on "golden parachutes" if proposed say-on-pay legislation in enacted.

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This letter was authored by DJ Shetty, with research assistance from Rich Alpern, Lou Taormina, Eric Winikoff, Silvana Nuzzo and Stephan Bosshard. Questions and/or comments should be directed to Mr. Shetty in our New York office at djshetty@fwcook.com or (212) 299-3716. This letter and other published materials are available on our website, www.fwcook.com.

Companies in Research Sample

3M	Comcast	Goodyear Tire & Rubber	Merck	Supervalu
Abbott Laboratories	ConocoPhillips	Google	MetLife	Sysco
Aetna	Constellation Energy	Hess	Microsoft	Target
Alcoa	Costco Wholesale	Hewlett-Packard	Morgan Stanley	Tech Data
Allstate	CVS Caremark	Home Depot	Motorola	Tesoro
Amazon.com	Deere	Honeywell International	Murphy Oil	Time Warner
American Express	Dell	Humana	News Corp.	TJX
AmerisourceBergen	Delta Air Lines	Ingram Micro	Nike	Travelers Cos.
AMR	DirecTV	Intel	Northrop Grumman	Tyson Foods
Apple	Dow Chemical	IBM	Nucor	U.S. Bancorp
Archer Daniels Midland	DuPont	International Paper	Occidental Petroleum	United Airlines
AT&T	Eli Lilly	J.P. Morgan Chase & Co.	Oracle	United Parcel Service
Bank of America Corp.	Emerson Electric	Johnson & Johnson	PepsiCo	United States Steel
Best Buy	Enterprise GP Holdings	Johnson Controls	Pfizer	United Technologies
Boeing	Exelon	Kimberly-Clark	Philip Morris International	UnitedHealth Group
Bristol-Myers Squibb	Express Scripts	Kraft Foods	Plains All American Pipeline	Valero Energy
Cardinal Health	Exxon Mobil	Kroger	Procter & Gamble	Verizon Communications
Caterpillar	Fannie Mae	Lockheed Martin	Prudential Financial	Walgreen
Chevron	FedEx	Lowe's	Raytheon	Wal-Mart Stores
CHS	Fluor	Macy's	Rite Aid	Walt Disney
Cigna	Ford Motor	Manpower	Safeway	WellPoint
Cisco Systems	General Dynamics	Marathon Oil	Sears Holdings	Wells Fargo
Citigroup	General Electric	McDonalds	Sprint Nextel	Whirlpool
Coca-Cola	General Motors	McKesson	Staples	World Fuel Services
Coca-Cola Enterprises	Goldman Sachs Group	Medco Health Solutions	Sunoco	Wyeth

Summary Financial Data of Research Sample

	Revenues ($ Millions)	Market Capitalization as of 8/31/09 ($ Millions)	Net Income ($ Millions)
75th Percentile	$59,034	$56,292	$3,528
Average	55,001	46,524	1,489
Median	35,470	26,160	1,707
25th Percentile	24,080	11,309	164