FREDERIC W. COOK & CO., INC.
90 PARK AVENUE, NEW YORK, N.Y. 10016 - TEL. (212) 986-6330
NEW YORK • CHICAGO • LOS ANGELES

May 2, 2003

BOARD OF DIRECTOR COMPENSATION: A CHANGING ENVIRONMENT

Total board compensation is increasing. In particular, we see increases in committee meeting/retainer fees and chairperson fees to reflect the additional time commitment required at the committee level. In addition, we see companies establishing a "lead director" role on the board to reinforce board independence where the CEO also is Chairman. In terms of equity compensation, we are starting to see a shift away from options to full value shares. We expect director ownership guidelines, an indicator of sound governance practices, to increase in prevalence as well.

Summary

Compliance with new corporate governance standards has required board members to commit greater time while still under the shadow of increased liability. These circumstances are leading to changes in how companies compensate board members. Based on an initial review of 2003 company proxy statements, we see several major changes in compensation for board members.

Background

Recent corporate scandals at such large companies as Enron, WorldCom, Tyco, HealthSouth, etc., have shaken investor confidence in not only corporate executives but also board members whose fiduciary duty is to protect shareholders from these very occurrences. In response to these scandals, unprecedented action has been taken by legislators, self-regulatory agencies, institutional investors and the national exchanges to restore investor confidence in corporate America. As a result, board members, particularly those at the committee level, are spending substantially more time on board activities while facing the risk of increased liability for their actions.

In addition, companies are finding that certain board members must be removed and replaced with "financial experts" or "independent" directors. Boards are experiencing difficulty finding directors and are re-examining what they should pay their board members once they find them.

As a general rule, board of director compensation can be broken down into several components: annual board retainer, board and committee meeting fees, committee chairperson/member retainers and equity awards. For various reasons, companies choose to compensate directors using a combination of the methods stated above. However, given today's corporate environment, several trends are beginning to develop. We believe that these trends will increase in prevalence as companies are forced to address these issues to remain competitive and continue to attract competent board members to serve their shareholders.

Current Trends

The following list illustrates trends that we see developing in board of director remuneration. Refer to the Appendix for detailed company board compensation descriptions.

- Overall increase in total board remuneration due to increased demands placed on board members and scarcity of quality "independent" directors
  - Responsibility levels have increased as has the expectation that directors will commit more time to board activities
  - In general, we have seen an increase in annual retainers coupled with a decreased weighting on equity compensation, resulting in a more equal balance between cash and equity compensation
- Establishment of a lead director whose role is to be the independent voice of the board
  - A major role of the lead independent director is to chair executive sessions of the board with pay generally ranging from $10,000 to $50,000, depending upon role
  - Examples include: Intel and United Technologies
- Shift away from options-only director plans to a mixture of options and other long-term incentives
  - Several companies have eliminated option grants entirely
  - Other equity compensation may consist of restricted stock awards or deferred stock units which are viewed as providing a stronger alignment between directors' and shareholders' long-term interests than stock options
    - These units are often deferred until the director leaves the board
  - Even those companies that have not committed to moving away from options are at least weighing the alternatives
  - Examples include: Altria, AOL Time Warner, Bank of America, General Electric, Intel, US Bancorp and Waste Management
- Decreased use of programs that could be perceived as making directors "beholden" to management, e.g., equity awards with long vesting schedules which could compromise their independence
  - Shorter vesting periods or immediate vesting upon grant
  - Examples includes: General Electric and PacifiCare

- Increased retainers for chairpersons of major committees, in particular, the audit committee
    - In some cases, cash retainers for chairpersons of committees have doubled or increased even more
    - Examples include: Bank of America, General Electric, Marathon Oil, PacifiCare, US Bancorp and Waste Management
- Establishment of director ownership guidelines that require directors to acquire and hold company stock in an effort to align investor and board long-term interests
    - Historically, a multiple of retainer approach, is the most prevalent
        - E.g., director must acquire shares equal to three times his/her retainer within three years
    - However, a developing trend is the "retention" ratio which requires directors to retain a percentage of net "profit" shares acquired upon option exercise
    - Some companies are not implementing formal ownership guidelines but are requiring directors to hold on to shares for a given time period (e.g., one year after option exercise for "profit" shares) or until termination of service or one year thereafter for deferred shares
    - Examples include: AOL Time Warner and Nextel Communications

* * * * * *

General questions about this letter can be addressed to Louis C. Taormina in our New York office at 212-986-6330 or by e-mail at lctaormina@fwcook.com. Copies of this letter and published materials are available on our website at www.fwcook.com.

EXAMPLES OF MAJOR BOARD OF DIRECTOR COMPENSATION CHANGES

The following are specific examples of the trends discussed above. All information is from publicly disclosed proxy statements.

- **Altria**
  - Increased board and committee meeting fees to $2,000 each from $1,500 and $1,000, respectively (committee chairs still receive $2,500 per meeting)
  - All committee chairmen will receive $10,000 annual retainer (previously Audit and Compensation committee chairs received $10,000 each, while Nominating, Public Affairs and Social Responsibility committee chairs received $5,000)
  - Eliminated stock option awards and instead will increase the aggregate fair market value of the annual share award from $40,000 to $55,000
    - Annual shares subject to one-year vesting period
    - Previous option awards calculated by dividing $40,000 by Black-Scholes value
  - Maintained $40,000 annual cash retainer
- **AOL Time Warner**
  - Implemented annual cash retainer of $50,000 and annual award of restricted stock with a value of $72,000
    - Restricted stock vests in equal annual installments on the first four anniversaries of grant date
    - Prior program was an all-equity program consisting entirely of option grants
  - Reduced option grant to 8,000 shares from 40,000 option shares annually
    - Options vest in installments of 25% over a four-year period and immediately if the director does not stand for re-election or is not re-elected, unless the Board determines otherwise

- Also, directors required to retain for one year shares of stock representing at least 75% of the gain realized upon exercise of stock options or vesting of restricted stock, after paying the exercise price and taxes at an assumed rate of 50%

- Note that modification in 2003 reduces the total estimated value of the annual compensation provided to non-employee directors

• **Bank of America**

- Implemented committee chairperson annual retainer fee of $20,000 for all committees, except the corporate governance chair who receives $10,000

- Eliminated 4,000 share option grant and replaced it with restricted stock grant valued at $80,500 and one-year vesting requirement

- Maintained $100,000 annual retainer paid 40% in restricted stock and 60% in cash, in addition to $1,500 per board or committee meeting

    - Restricted stock subject to one-year vesting requirement

• **General Electric**

- Under the new program, annual compensation of $250,000 will be paid in four installments, 40% (or $100,000) in cash and 60% (or $150,000) in deferred stock units (DSUs)

    - Replaces old program which paid annual retainer of $75,000, board and committee meeting fees of $2,000 and stock option grant of 18,000 shares with estimated value of $168,000

- Each DSU will be equal in value to a share of GE stock, but will not have voting rights

    - DSUs will accumulate regular quarterly dividends that will be reinvested in additional DSUs

    - DSUs will be paid out in cash to directors beginning one year after they leave the board

    - Directors may elect to take their DSU payments as a lump sum or in equal payments spread out for up to ten years

- Additional payments of $25,000 for Audit and Compensation Committee service will be made in the same 40%-60% proportion between cash and DSUs

- Eliminated stock option plan for directors for the following reasons:

- -- Simplifies directors’ compensation

- -- DSUs more closely align the directors’ interests with the long-term interests of shareowners

— For previously granted options, now require directors to hold for at least one year the net shares obtained from exercising stock options after selling sufficient shares to cover the exercise price and taxes (also a requirement for senior executives)

- **Intel**

  — Increased annual retainer to $60,000 from $24,000 and eliminated $4,000 board meeting fees

  — Increased lead director retainer to $20,000 from $9,000

  — Audit committee chair retainer increased to $20,000 from $7,500 and other committee chair retainers to $10,000 from $3,000

  — Decided to review the use of annual stock option grants to directors and the possible use of other equity-related incentives such as restricted stock (previously made annual grant of 15,000 options)

- **Marathon Oil**

  — Continues to pay $60,000 annual retainer (50% in deferred units, 50% in cash), $2,000 for board and committee meeting fees and $5,000 per committee membership ($6,000 for chair)

  — All non-employee directors are required to defer half of annual retainers in the form of common stock units with dividend equivalents

  — Increased non-employee chairman fee considerably from $25,000 per year to $240,000

- **Nextel Communications**

  — Implemented $50,000 retainer, of which $20,000 will be paid in cash (subject to the director’s election to defer all or a portion into shares of deferred stock) and $30,000 of which will be paid in shares of deferred stock, subject to a one-year vesting period and a one-year holding period thereafter

  — Annual grant of 10,000 options for each director and an additional 5,000 options for each committee chaired both of which vest at the next quarterly grant date

  - -- Shift from prior years when director compensation was paid <u>entirely</u> in stock options

- — $1,000 payment (subject to the director's election to defer all or a portion into shares of deferred stock) for each meeting attended that lasts more than three hours

- — Chairman of the board receives, in lieu of all other compensation, 62,500 option shares which vest at the next quarterly grant date

- — Adopted stock ownership guidelines requiring directors to hold at least $200,000 of equity within five years from either the date of their first election to the board and November 14, 2007, whichever is later

- **PacifiCare**

  - — Maintained annual retainer of $40,000

  - — Increased board and committee meeting fees to $1,500 each from $1,200 and $1,000, respectively

    - -- Note that beginning in 2003, committee chairpersons receive the same per-meeting fees as non-chairpersons (prior to this, they received $2,000 per meeting as chairperson)

  - — In 2003, Board approved retainers to Chairman of the Board and committee chairpersons

    - -- Chairman of the Board receives $75,000 annually

    - -- Audit, Finance and Ethics Committee chairperson receives $20,000 annually

    - -- Compensation Committee chairperson receives $10,000 annually

    - -- All other Committee chairpersons receive $5,000 annually

  - — Maintained annual stock option grant of 5,000 shares which vest immediately (except for the Chairman who receives 10,000) provided that the underlying common stock may not be sold within the first six months after the grant date

- **US Bancorp**

  - — Increased annual retainer from $40,000 to $60,000 and annual committee chairman fee from $5,000 to $10,000

- Eliminated board and committee attendance fees of $1,500 and $1,000 per meeting, respectively
- Switched from an annual all-option grant of 8,600 shares to a combination of 7,200 option shares and 2,500 restricted shares
    - Restricted stock units and stock options vest in four equal, annual increments beginning one year from the date of grant

• **United Technologies**

- Increased annual retainer to $100,000 from $70,000
- New program pays Audit members $25,000, and $10,000 for committee chairs (except Audit, which receives $35,000)
    - Increased from last year when $5,000 was paid for committee chairs
- Director designated to preside at executive sessions of the non-management directors receives $35,000 annual retainer
- Will receive 4,000 stock options vesting at the end of three years as opposed to an option grant valued at $70,000 in prior years
- Continue to provide a one-time grant of restricted stock units valued at $100,000 upon initial election to the Board
    - Dividend equivalents are credited on the units and vest ratably over five years, but may not be sold or otherwise transferred until the director retires or resigns from the Board

• **Waste Management**

- Increased cash retainer to $40,000 from $35,000 in the prior year
    - Board meetings increased to $2,000 from $1,500 and committee meetings to $1,500 from $1,250
    - Eliminated committee chairman meeting fees ($625 additional per meeting) and switched to a retainer of $10,000. In addition, audit committee members will receive an annual retainer of $5,000
- Eliminated annual 10,000 share option grant and replaced with $70,000 per year in stock units payable in common stock no earlier than one year following termination of service