Frederic W. Cook & Co., Inc.

New York • Chicago • Los Angeles

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Planning for the New Shareholder-Approval
Requirements for All Equity Grants to Employees

Imagine the following scenario:

- The NYSE proposed listing rule requiring shareholder approval of all employee equity plans is approved by the SEC;
- The Nasdaq conforms its rules to the NYSE either voluntarily or as directed by the SEC;
- The effective date for the new rules is the first annual meeting following December 31, 2002;
- All grants made before the effective date are grandfathered, but grandfathering does not apply to Board-approved plan shares that have not yet been granted;
- The new NYSE/Nasdaq rules eliminate all current exemptions from the shareholder-approval requirements including broad-based plans, treasury stock, new hires, and the ability of brokers to vote shares held in "street name" in the absence of customer instructions; and
- The current firestorm over stock option abuses and excessive dilution continues unabated into the spring.

The above scenario is highly possible, and perhaps likely. By removing the ability of brokers to vote shares in the absence of customer instructions, the voting power of institutional holders is increased. The implication is a higher risk of management stock plan proposals failing, particularly if the company has a high proportion of share ownership by individual investors (as opposed to institutions) and/or high potential share dilution from outstanding stock option and other equity awards (i.e., overhang).

Another fact that seems to have gone largely unnoticed is that the NYSE proposed rule applies to uses of stock under all *equity* plans, not just stock option plans. Thus, the rule change may apply to restricted stock grants, LTIPs paid out in shares, bonuses paid out in restricted stock, voluntarily deferred stock paid out in actual shares, employee stock purchase plans, equity grants for outside directors, and even small grants of stock to lower-level employees as part of reward/recognition programs.

Companies with such grant practices under non-shareholder-approved plans will be able to continue to make grants up until the effective date, but presumably not thereafter.* If the effective date is the next annual meeting, then any company wishing to continue such grant practices into the following fiscal year will need to consider seeking shareholder approval at its next annual meeting. Those with enough shares in their shareholder-approved plans to meet their equity needs in 2003 and perhaps 2004 are more fortunate. They can wait for the dust to settle and then formulate their plans in such a way as to maximize their potential for shareholder approval.

Some of the critical issues to explore when seeking shareholder approval of an equity compensation plan include: the best type of plan to put before shareholders (omnibus or separate stock option and equity award plans); the plan terms most likely to win shareholder approval; the number of shares to reserve and the structure of the share recapture provisions to maximize the life of the share pool; whether to adopt and communicate a target annual share grant "run rate" and "target overhang" as of each annual meeting date; sources of shares for the plan; whether a special campaign should be developed and launched to "sell" the plan to individual and institutional shareholders; and how to most effectively use the shares that are authorized.

It is our intent in this letter to alert clients and friends of the firm to the confluence of forces that are likely to restrain companies' ability to use equity incentives as freely in the future as in the past.

Questions about this letter may be directed to Fred Cook at 212-986-6330. This and other mailings of our firm are available at www.fwcook.com

* It is unclear whether any grandfathering would apply to restricted stock *unit* grants and deferred compensation plans under which grants have been made but actual shares would not be issued until vesting or retirement