October 20, 1998

**A REMINDER TO
EXECUTIVE COMPENSATION PROFESSIONALS:
HELP YOUR COMPANY PRESERVE THE
DEDUCTIBILITY OF EXECUTIVE COMPENSATION**

Many of our clients have adopted polices to preserve the tax deductibility of top executive compensation by availing themselves of the "performance-based exemption" under Internal Revenue Code §162(m) for compensation in excess of $1 million. They have done so by obtaining shareholder approval for annual and longer-term incentive plans that meet the requirements of IRC §162(m), including specifying individual grant or payment limits and identifying the performance measures that can be used to drive payouts. Additionally, they have structured and empowered their board compensation committees to administer these plans in accordance with the IRS regulations.

Nonetheless, several years have passed since this subject was in the forefront of the compensation community's attention. Companies may have grown lax in adhering to the detailed administrative requirements of the law and regulations. This could prove embarrassing and expensive if a tax audit found that compensation otherwise thought to be deductible was not as a result of administrative oversight.

Therefore, as we approach the end of one incentive year for most companies and the start of another, it is timely for you to conduct an internal review to ensure that:

1. The compensation committee is setting specific performance goals and payout schedules for annual and longer-term incentive plans for executive officers within the first three months of the performance period (or within the period's first quarter if the period is less than a year), using approved performance measures, and that such measures, goals and payout schedules are included in committee minutes.

2. At the same time and in the same committee minutes, the committee is pre-excluding any extraordinary, unusual or nonrecurring items that it may wish to later exclude in calculating earned awards at the end of the period.

3. All annual incentive awards and all stock option, performance shares or performance unit grants are administered within the individual grant limits specified in the shareholder-approved plan.

4. At the end of the performance period, the compensation committee is approving payouts for executive officers strictly in accordance with actual performance achieved in relation to the goals and payout schedules set at the start of the period, subject only to "negative

discretion," and that such actions are reflected in the committee's minutes before payments are made.

Further, companies should be reminded that IRC §162(m) requires reapproval of the performance measures and individual grant or payout limits under annual and longer-term incentive and stock option plans, unless maximum payout amounts are determined by an enduring plan formula, by shareholders at least every five years. This will be the 1999 proxy season for many companies.

Finally, companies that have had an initial public offering within the past five years are reminded that they must seek shareholder approval of complying plans within three years of their IPO to preserve the performance-based exemption for top executive compensation. Spin-offs from public companies have one year to seek such approval. Those with grandfathered executive employment agreements are reminded that the deductibility of payment required under these agreements remains valid only so long as such agreements are not amended to increase benefits.

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The foregoing is a general description of the requirements under IRC §162(m) and may not fit every company's situation. Therefore, close coordination with legal counsel is necessary in conducting such a review.

Questions about this letter can be addressed to Fred Cook in the New York office (212-986-6330). Copies of this letter and other published materials are available on our web site, WWW.FREDERICWCOOK.COM.