

FREDERIC W. COOK & CO., INC.

THE 2006 TOP 250

*Long-Term Incentive
Grant Practices for Executives*

OCTOBER 2006

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EXECUTIVE SUMMARY

The last four years have been a tumultuous time for executive compensation as public companies have responded to a regulatory onslaught. Starting with the adoption of Sarbanes-Oxley in 2002, changes in stock exchange listing requirements, tax laws, accounting principles, and pay disclosure rules have profoundly affected the way leaders of U.S. public companies have been paid, with changes most pronounced in the area of long-term incentives (LTI).

Now in 2006, a key challenge facing public companies is balancing the demand for transparency and clarity with the seemingly incompatible factor of increased complexity in executive compensation. The Security and Exchange Commission's (SEC's) 436 pages of regulatory requirements and discussion on the disclosure of executive pay are the quintessence of the challenge (not to mention the full implementation in 2006 of the Financial Accounting Standards Board's (FASB's) new standard on "share-based payment," FAS 123(R), a mere 286 pages in length).

But it appears that long-term incentive practices for executives are starting to stabilize, based on recent Frederic W. Cook & Co. research on practices at the 250 largest U.S. companies. Key findings from the Frederic W. Cook & Co. 2006 Top 250 report include the following:

- The prevalence of long-term incentive grant types continue to change (including a shift away from stock options towards restricted stock and performance awards), but at a slower pace than last year.
- Stock option variations (such as "reloads" or "premium" options) have largely disappeared, with "plain vanilla" options the flavor of choice.
- Median long-term incentive values for CEOs have barely budged for the last five years, with 75th percentile grants flat after several years of decline.

Other findings of general interest from the 2006 report include the following:

- The value of restricted stock awards for the first time exceeded stock option values for the CEOs of companies that voluntarily adopted FAS 123(R) earlier than required.
- Nearly 20 percent of companies have shortened option terms from the standard 10-year term.
- Vesting of both stock options and restricted stock extends over four or more years at 50 percent of companies.
- For companies using long-term performance awards, profit measures are most commonly used to determine payouts (51 percent of companies), followed by total shareholder return (38 percent of companies).

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

INTRODUCTION

BACKGROUND AND OVERVIEW

Since 1973, **Frederic W. Cook & Co.** has researched and published annual reports on long-term incentive grant practices for executives. This 2006 report, our 34th edition, presents information on long-term incentives currently in use for executives of the 250 largest U.S. companies in the Standard & Poor's 500 Index as reported in the Special Spring 2006 issue of *BusinessWeek* 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, 2006.

SURVEY SCOPE

Three main areas of executive compensation are covered by this report: long-term incentive grant types and variations, CEO long-term incentive values over a five-year period, and other related equity grant practices, including the addition this year of vesting periods and performance measures. As done for the past several years while the new accounting rules were being implemented, practices have been analyzed separately for companies which voluntarily adopted FAS 123(R) prior to the required date ("FAS 123 companies" as distinguished from "Non-FAS 123 companies").

The grant type 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, all information was obtained from documents filed with the SEC including company proxy statement, annual report, 10-Q, 10-K, and 8-K filings. As Form 8-K disclosure is required within four business days of making material changes to compensation and benefit arrangements, the results tend to more closely reflect "real time" current-year (i.e., 2006) practice rather than prior-year (i.e., 2005).

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 because, as noted above, company size at a given point of time determines inclusion in this report. In terms of the 2006 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. For the CEO analysis, however, this year's sample is the same over a five-year period, although the sample does differ somewhat from that used in the 2005 Top 250 report.

Note that in some circumstances totals may not add up to 100 percent due to rounding or companies having more than one type of practice.

DEFINITION OF USAGE

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 reflects usage through fiscal year 2005, but the findings do, whenever possible, present more current grant practices for fiscal year 2006.

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

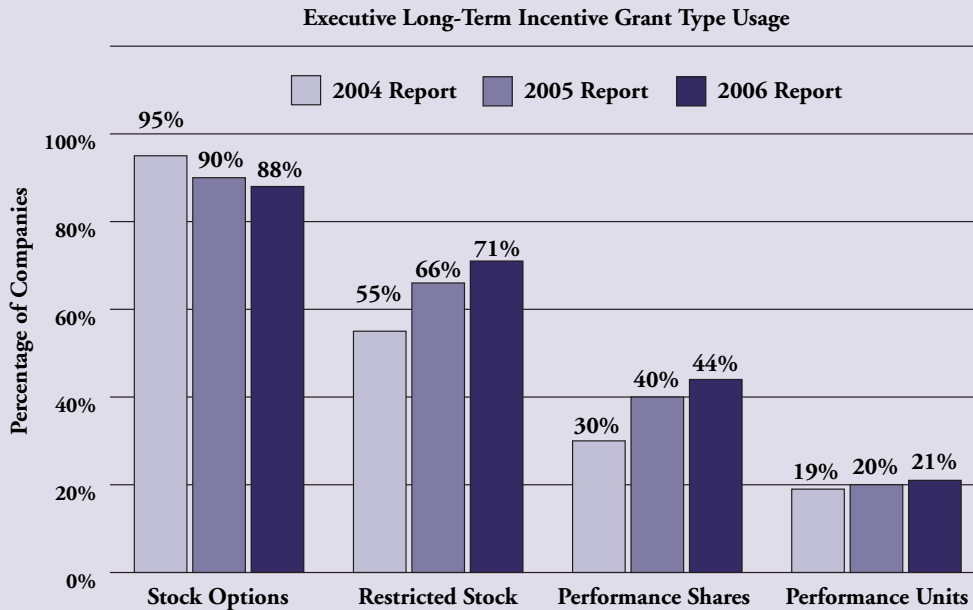
- The grant type must be made under a formal plan or practice, and may not be limited by both scope and frequency. A grant with *limited scope* is awarded to only a handful of key executives. A grant with *limited frequency* is an award that is not made consistently and appears to fall outside the principal long-term incentive program. For example, a grant determined to be made specifically as a hiring incentive, replacement of lost benefits upon hiring, or promotional award is not considered a long-term incentive for this report. 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) or future (indicated in proxy statement or Form 8-K) grants
Dropped	Eliminated or to-be-discontinued grants

GRANT TYPES AND USAGE

LONG-TERM INCENTIVE GRANT TYPES



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. Eighty-eight percent of the Top 250 companies grant stock options. Seven of the Top 250 companies that have used options in the past have dropped stock options from their long-term incentive programs this year or expect to do so next year.

Restricted Stock includes actual shares or share “units” that are earned solely by continued employment. Restricted stock is becoming almost as prevalent as stock options. Sixty-five percent of the Top 250 companies have historically granted restricted stock with six percent beginning to grant restricted stock either during the latest fiscal year or 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-two percent of the Top 250 companies use either one or both of these grant types, with twice as many companies using performance shares than performance units. These performance awards have been the fastest growing long-term incentive grant type with 12 percent of the Top 250 companies beginning to grant these types of awards either during the latest fiscal year or next year.

LONG-TERM INCENTIVE GRANT TYPES

Grant Type (See Appendix for definitions.)	Percentage of Companies Using Grant Type		
	2004 Report	2005 Report	2006 Report
Stock Options	95%	90%	88%
• Performance	6	6	3
– <i>Vesting</i>	1	3	1
– <i>Accelerated Vesting</i>	5	3	2
• Restoration (Reload)	10	6	2
• Premium	2	2	1
• Discount	<1	<1	0
• Indexed	1	0	<1
Restricted Stock	55%	66%	71%
• PARSAPs	4	7	7
Performance Shares	30%	40%	44%
Performance Units	19%	20%	21%
SARs	3%	3%	5%
• Tandem	1	<1	<1
• Freestanding	2	2	4
• Additive	0	0	0
Tandem Grants	1%	0%	0%
Formula-Value Grants	<1%	<1%	<1%

STOCK OPTION DESIGN FEATURES

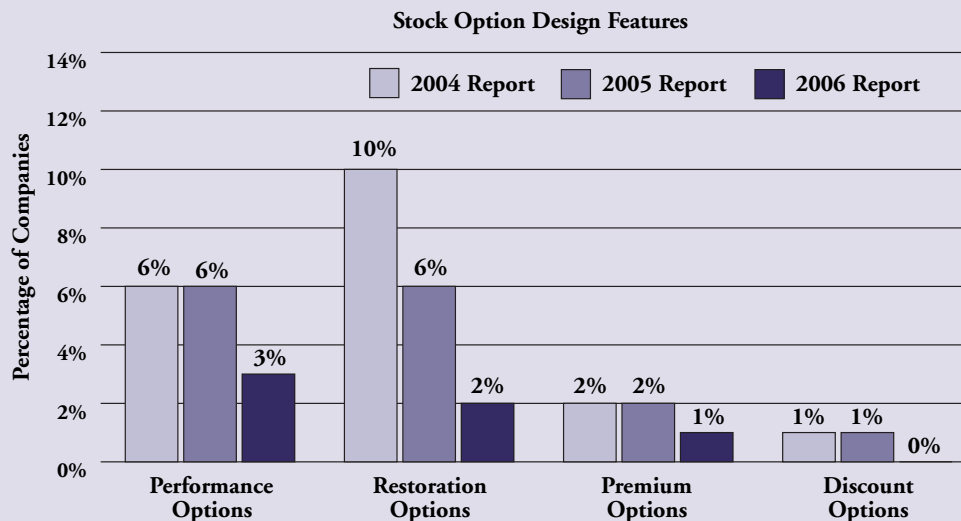
Overview – Among the Top 250 companies, seven percent incorporate one or more design feature into their stock option grants. The following are the principal option grant design features in use at the Top 250 companies:

Performance Stock Options are stock options with vesting tied in some manner to specified performance criteria. Overall, performance options are used by three percent of Top 250 companies. Two percent of the Top 250 companies use performance criteria to *accelerate* vesting. Over the last three years, the use of options with performance-accelerated vesting has continued to decline, 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. Although use of “earn it or lose it” types of options had been expected to increase in prevalence once option expensing is implemented there has been a decline in usage. One percent of the Top 250 companies use performance-vesting options, versus three percent from last year’s study.

Restoration (Reload) Stock Options are options granted with a feature that typically allows for additional options to be granted that replace or “restore” already-owned shares exchanged in a “stock-for-stock” exercise. They are designed to encourage management stock ownership. In total, six percent of the Top 250 companies (15 companies) grant restoration options while four percent (10 companies) explicitly stated that they will no longer grant these types of awards going forward and/or they eliminated their stock option program. Thus, we assumed that two percent (five companies) continue to grant reloads. Restoration options will likely become extinct because they must be accounted for as a separate grant under FAS 123(R) and reported as a separate grant under the new SEC proxy disclosure rules.

Premium and Discount Stock Options have an exercise price *above* or *below* the market price at grant, respectively. One percent of the Top 250 companies use premium stock options. Discount stock options have disappeared because there are adverse tax consequences under the new deferred compensation rules (IRC 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 Opinion 25, complex measurement under FAS 123(R), and the complicated design and administrative issues associated with them.



STOCK OPTION DESIGN FEATURES

Performance Stock Options*Performance-Vesting –*

Marsh & McLennan
 Transocean
 Zimmer Holdings

Performance-Accelerated Vesting –

Bristol-Myers Squibb
 Hartford Financial Services
 Kroger
 Lehman Brothers Holdings
 SLM

Restoration Stock Options

3M*
 Abbott Laboratories*
 Alcoa*
 Capital One Financial*
 Corning*
 Illinois Tool Works*
 Kellogg
 Masco*
 McGraw-Hill
 Mellon Financial*
 Morgan Stanley*
 National City*
 North Fork Bancorporation
 Valero Energy*
 Wellpoint

Premium Stock Options

International Business Machines
 (Charles) Schwab
 Tyco International

Indexed Stock Options

Schering-Plough

* Company specifically stated that restoration (reload) stock options will be eliminated going forward

OTHER GRANT TYPE VARIATIONS

Overview - Other grant type variations used by the Top 250 companies include the following:

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. Five 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. In the future, stock-settled SARs usage may increase since they limit dilution, expand the life of the plan share reserve and ease administration. Of those companies that grant SARs or plan to do so, the majority (9 of 12) have adopted FAS 123(R). While different types of SARs can be granted, most companies (11 of 12) grant those that are “freestanding” in replacement of option grants.

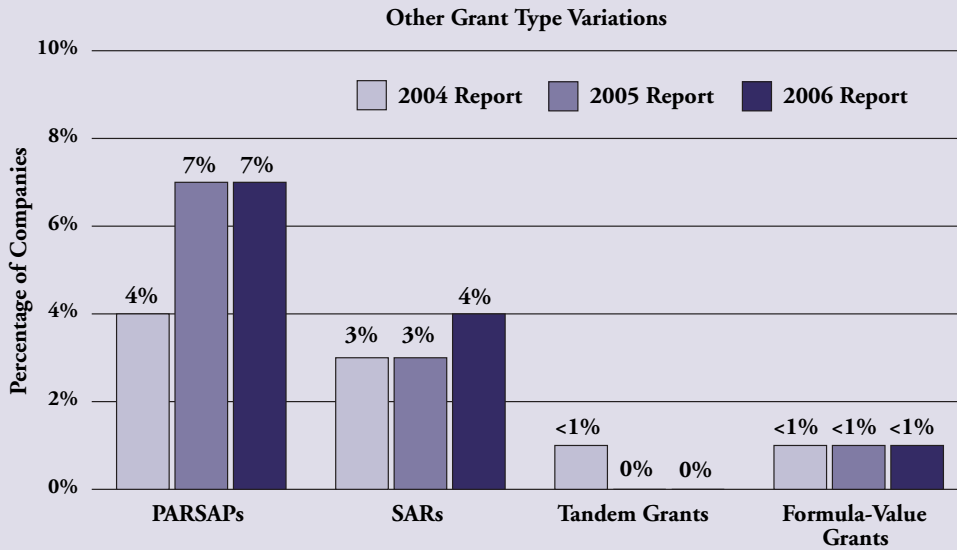
- **Tandem SARs** are granted in “tandem” with stock options, with the exercise of one canceling the other. Only one of the Top 250 companies (Masco) grants tandem SARs.
- **Freestanding SARs** provide for a payment equal to the appreciation on “phantom” shares, without regard to an underlying stock option.
- **Additive SARs** are rights granted in addition to a stock option. None of the Top 250 companies has granted additive SARs since 1996, and are unlikely to do so in the future due to limitations under IRC Section 409A.

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, seven percent of the Top 250 companies grant PARSAPs, with the highest prevalence among Non-FAS 123 companies because ultimate vesting by time preserved fixed grant-date accounting treatment under the prior accounting standard (APB Opinion 25).

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 have granted these types of awards since 2004.

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 and restricted stock as part of its annual long-term incentive program.

OTHER GRANT TYPE VARIATIONS



SARs

Freestanding -

Aetna
 Apache
 Becton Dickinson
 Express Scripts
 Fifth Third Bancorp

Genworth Financial
 J. P. Morgan Chase
 Marriot International
 Occidental Petroleum
 State Street
 United Technologies

Tandem -

Masco

PARSAPs

CIGNA
 Countrywide Financial
 Dominion Resources
 Duke Energy
 EMC
 First Data
 Harley-Davidson
 Harrahs Entertainment
 H.J. Heinz

Kinder Morgan
 Lowes Cos
 Mellon Financial
 Moody's
 Norfolk Southern
 Regions Financial
 Starwood Hotels & Resorts
 Worldwide
 SunTrust Banks

Formula-Value Grants

Johnson & Johnson

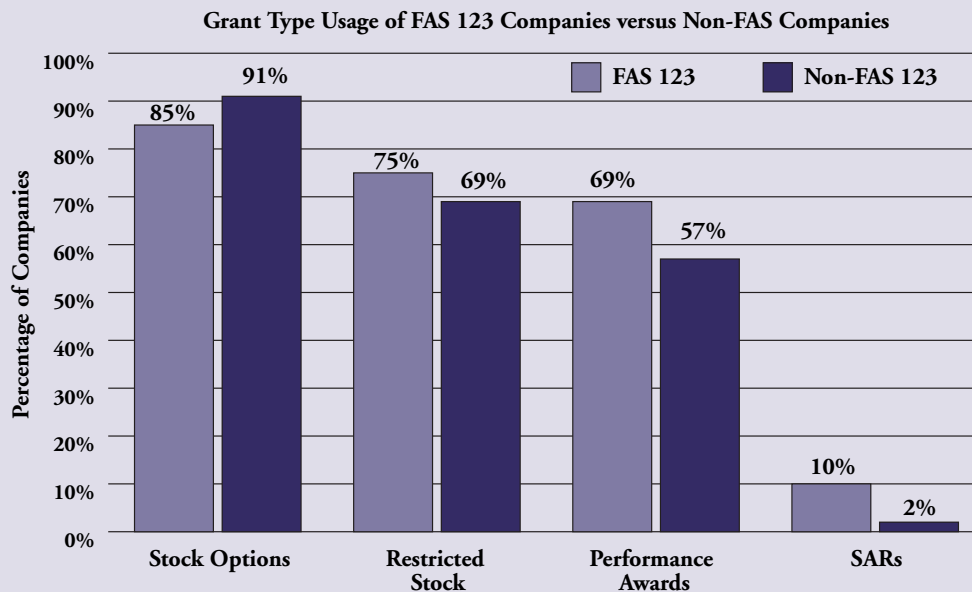
GRANT TYPES AND USAGE

FAS 123 COMPANIES

“Early adopters” of option expensing include 91 of the Top 250 companies which voluntarily adopted “fair value” accounting for stock-based grants as prescribed under FAS 123(R) (“FAS 123 companies”) in advance of the required adoption date. While stock options at all companies will now carry an expense (“fair value”) on the date of grant that flows through the income statement, this separate analysis has been continued as an indicator of possible future practice after the effect of the new accounting rules has been fully implemented.

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 (85 percent), restricted stock (75 percent), and performance awards (69 percent including both shares and units) is converging among FAS 123 companies.
- SARs are used more frequently at FAS 123 companies (10 percent) than Non-FAS 123 companies (2 percent).



FAS 123 COMPANIES

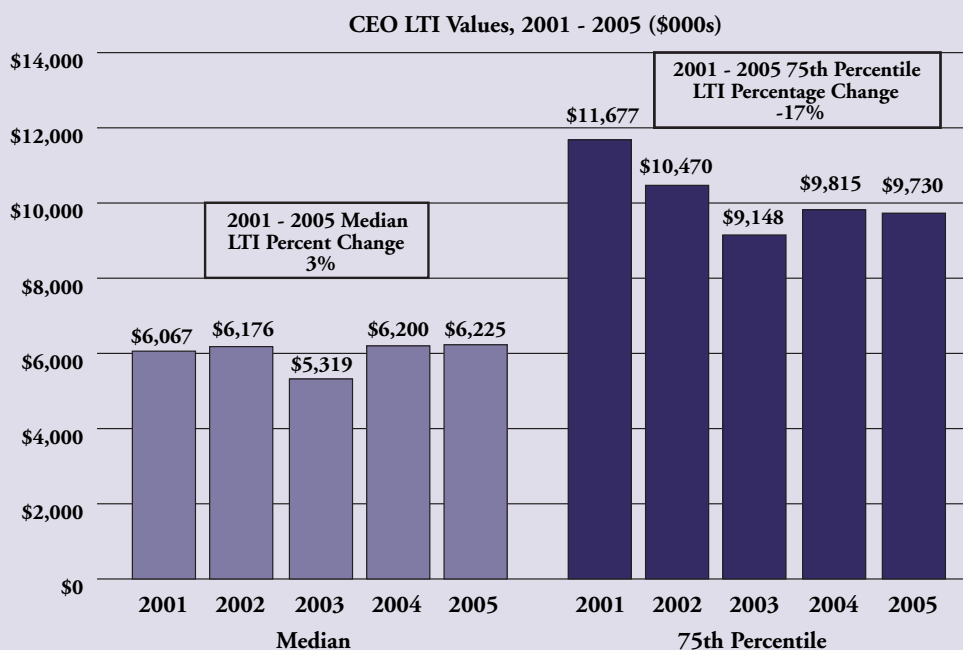
AFLAC	Fifth Third Bancorp	National City
Allstate	Ford Motor	Occidental Petroleum
Amazon.com	FPL Group	PepsiCo
American Express	General Electric	PNC Financial Services
American International Group	Genworth Financial	Principal Financial
Anadarko Petroleum	Goldman Sachs Group	Progressive
Apache	Harley-Davidson	Prudential Financial
Archer Daniels Midland	Hartford Financial Services	Reynolds American
AT&T	Home Depot	Schlumberger
Bank of America	Illinois Tool Works	Sears Holdings
Bank of New York	International Business Machines	Simon Property Group
Bear Stearns	Johnson Controls	Sprint Nextel
Becton Dickinson	J. P. Morgan Chase	St. Paul Travelers
BellSouth	KeyCorp	State Street
Boeing	Kohl's	SunTrust Banks
CA	Lehman Brothers Holdings	Target
Capital One Financial	Eli Lilly & Company	Texas Instruments
Chevron	Lockheed Martin	Transocean
Chubb	Lowes Cos	TXU
CIGNA	M & T Bank	Tyco International
Citigroup	Marathon Oil	U. S. Bancorp
Coca-Cola	Marsh & McLennan	United Parcel Service
ConocoPhillips	Masco	United Technologies
Costco Wholesale	McDonald's	Verizon Communications
The Walt Disney Company	Mellon Financial	Wachovia
Dow Chemical	Merrill Lynch	Wal-Mart Stores
E.I. du Pont de Nemours	MetLife	Washington Mutual
Emerson Electric	Microsoft	Weatherford International
Entergy	Moody's	XL Capital
Equity Residential	Morgan Stanley	Yum! Brands
ExxonMobil		

CEO LONG-TERM INCENTIVE VALUES

CEO LONG-TERM INCENTIVE TRENDS: VALUES AND GRANT TYPES

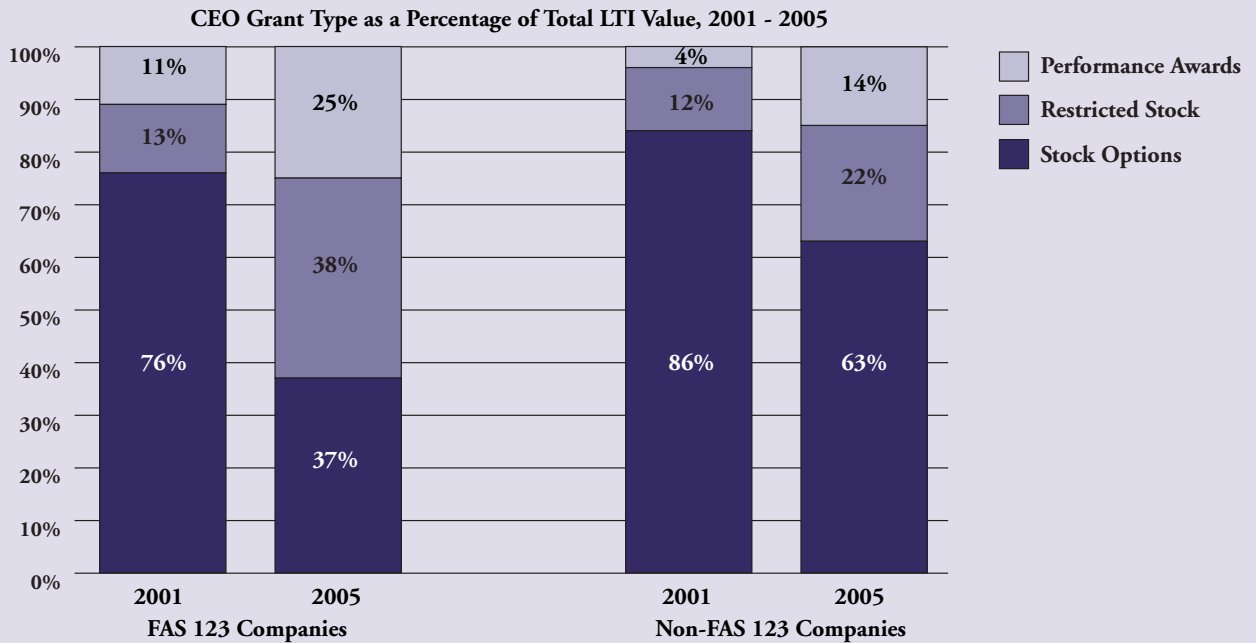
As in the prior two years' reports, this year's report includes an analysis of CEO long-term incentive values, covering years 2001 through 2005. The sample is consistent year-over-year and represents those companies from the Top 250 where the CEOs have been in their roles for at least five years (121 in total). Stock options are valued using company weighted-average fair values; restricted stock is valued at grant; performance share targets are valued at grant; performance unit target values are discounted at five percent for the number of years in the performance period.

As shown below, median long-term incentive values to these "same sample" CEOs have been basically unchanged over the last five years up only slightly (three percent) in 2005 versus 2001, dipping somewhat in 2003. At the 75th percentile, 2005 values have fallen by 17% since 2001.



CEO GRANT MIX AS PERCENTAGE OF OVERALL LONG-TERM INCENTIVE VALUE

Similar to our findings with respect to the Top 250 companies, the mix of long-term incentive delivered to the CEO also shifted away from options. Long-term incentive grant mix continued to trend towards 40 percent options and 60 percent full-value awards (i.e., restricted stock and performance awards) for FAS 123 companies, with restricted stock values slightly exceeding option values. Non-FAS 123 companies exhibited similar, but less pronounced movement towards full-value awards. The following chart compares the percentage of total long-term incentive value delivered in various grant types to CEOs in 2001 and 2005 at FAS 123 and Non-FAS 123 companies:



OTHER LONG-TERM INCENTIVE PRACTICES

GRANT STRUCTURE

This year, the Top 250 analysis was expanded to include other key long-term incentive grant terms and provisions, including the length of stock option terms, vesting provisions, and performance measures.

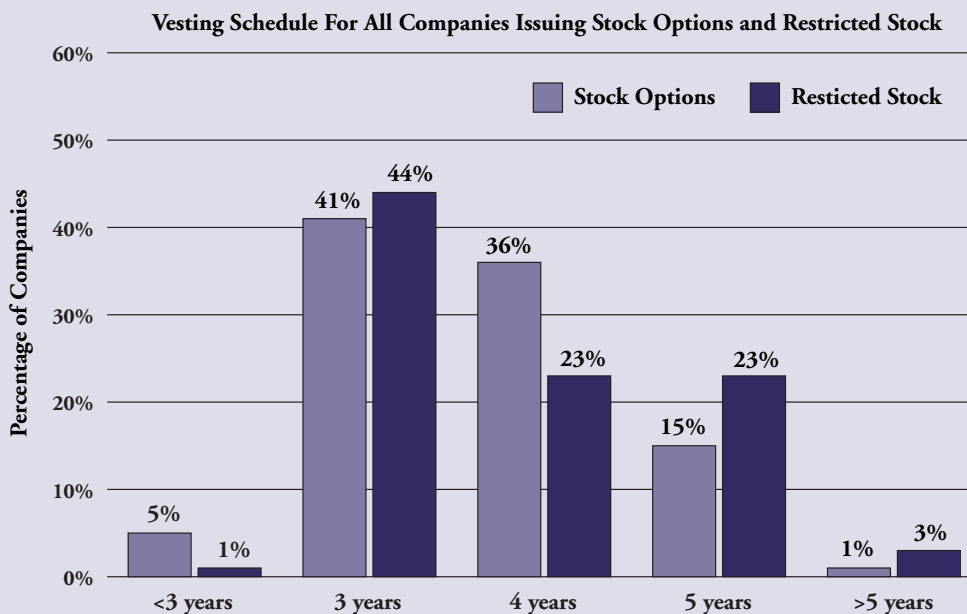
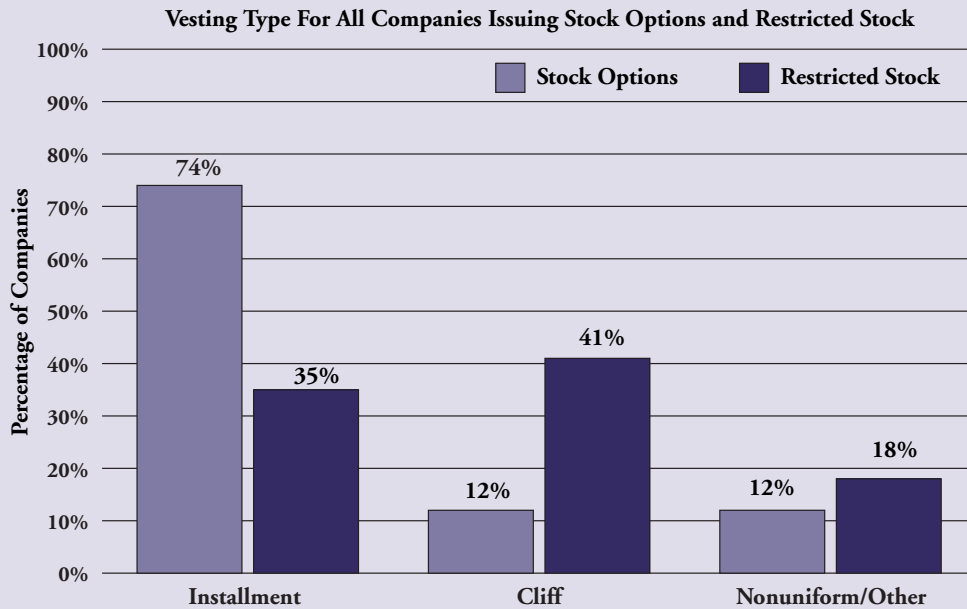
Stock Option Term – A majority of the Top 250 companies grant stock options with a 10-year option term although an increasing number of companies have shortened the option term to less than 10 years. Of the Top 250 companies that grant stock options, 82 percent (181 out of 222) have a 10-year option term and 18 percent (40 out of 222) have an option term of less than 10 years, with seven years being the most common alternative to the traditional 10-year term.

Term	Percent of Companies Using
> 10-year	0.5%
10-year	82%
9	1%
8	3%
7	10%
6	2%
5	1%

OTHER LONG-TERM INCENTIVE PRACTICES

Type of Vesting – Seventy-four percent (165 out of 222) of the Top 250 companies issuing stock options apply uniform (equal installment) vesting to their stock option grants. Restricted stock grants, in contrast, are more commonly subject to “cliff” vesting (i.e., 100 percent vesting after a specified number of years) than uniform installment vesting.

Vesting Period – Three years is the most common vesting period for both stock options (41 percent of companies) and restricted stock (44 percent of companies). About half of companies vest options and restricted shares over four or more years, however.



OTHER LONG-TERM INCENTIVE PRACTICES

Performance Award Measures – Fifty-one percent of the Top 250 companies issuing performance awards use some type of “profit” measure as a basis for award payout. Total shareholder return is the second most common performance measure (used by 38 percent of companies).

Category	Performance Measures	Percent of Companies Using
<i>Profit</i>	Earnings per share, net income, EBIT/EBITDA, operating income, pretax profit	51%
<i>Total Shareholder Return</i>	Stock price appreciation plus dividends	38%
<i>Efficiency</i>	Return on equity, return on assets, return on operating income, return on capital, economic value added	34%
<i>Other</i>	Cash flow, revenue growth, discretionary, individual performance	28%

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. Unchanged from last year's report, 10 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.)

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-six of the Top 250 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** was at one time common, but now is not used by any of the Top 250 companies.

MANDATORY PAYMENT OF ANNUAL INCENTIVES IN STOCK OR STOCK UNITS

Stock or Stock Units

Allergan	Franklin Resources	National City
American Electric Power	Gannett	News Corp
AON	Goldman Sachs Group	PNC Financial Services
Archer Daniels Midland	Johnson & Johnson	SLM
Bank of America	J. P. Morgan Chase	Starwood Hotels & Resorts
Bank of New York	Lehman Brothers Holdings	Worldwide
Bear Stearns	Mellon Financial	State Street
Citigroup	Merrill Lynch	SYSCO
E.I. du Pont de Nemours	Morgan Stanley	Wellpoint

OTHER LONG-TERM INCENTIVE PRACTICES

EXPECTED TRENDS IN LONG-TERM INCENTIVE GRANT PRACTICES

It is difficult to predict the future usage of the various grant types as there are a multitude of factors that influence program design including regulatory developments (such as FAS 123(R), IRC Section 409A, and the SEC's new proxy disclosure rules) as well as basic long-term incentive strategy. As in prior Top 250 reports, the following table attempts to predict future trends in executive long-term incentive practices in light of various considerations, and to compare current trends with the predictions. The forecasts and trends align in most cases but, as summarized below, not all.

Grant Type	Forecast Usage	Current Trend	Rationale for Forecast
Stock Options			
• Discount	Decrease	None	Low cost relative to perceived value delivered; however, carries poor shareholder optics and adverse tax consequences under IRC Section 409A
• Dividend Units	Increase	Flat	Total shareholder return option; dividends included in grant value vs. additional current expense, potential for adverse tax consequences under IRC Section 409A
• Incentive (ISOs)	Decrease	Decreasing	Lack of tax deductibility increases expense by reciprocal of tax rate
• Indexed	Flat	Flat	Strong linkage to performance; however, complicated design and administrative issues
• Performance-Accelerated Vesting	Decrease	Decreasing	No need for ultimate vest to preserve fixed expense
• Performance-Vesting	Increase	Decreasing	Strong link between pay and performance and expense reversible if not earned (if not market-based condition), but high cost relative to perceived value
• "Plain-Vanilla"	Decrease	Decreasing	High cost (fair value expense vs. none previously) relative to perceived employee value; not reversible if "under water"
• Premium	Flat	Flat	High cost relative to potential and "perceived" value; option "under water" at grant
• Price-Vesting	Increase	Decreasing	Discounted fixed expense at grant (although expense not reversible if not earned); but continues to be high cost relative to perceived value
• Restoration (Reload)	Decrease	Decreasing	Continued and uncontrollable costs; each "reload" grant separately expensed and reported in proxy
Restricted Stock			
• PARSAPs	Decrease	Flat	No longer necessary since performance-vesting has fixed expense
• Time-Vesting	Increase	Increasing	Provides program balance, with greater retentive power than options and alignment with share-holder interests, but weaker link to performance
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 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)

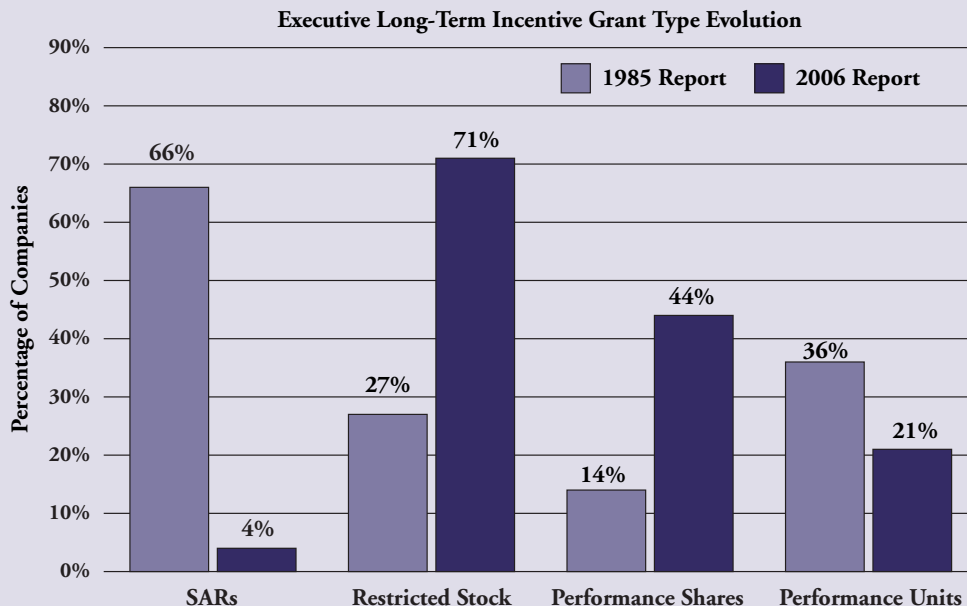
GRANT PRACTICE EVOLUTION

While executive long-term incentive grant practices have been undergoing a structural shift, it is important to recognize that grant usage has continually evolved over the years. Notable comparisons between 1985 (the first year we tracked actual usage of a particular grant type versus “availability”) and 2006 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, SARs have begun to reappear.

RESTRICTED STOCK – Twenty years ago, restricted stock was used by only a quarter of large companies, compared to nearly three-quarters 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. Also, performance-vesting stock options were used by almost 20 percent of companies as recently ago as 1999, but now are used by only one percent.



EXECUTIVE STOCK OWNERSHIP GUIDELINES

OVERVIEW – For the fourth year in a row, the prevalence of formal executive stock ownership policies continues to increase as companies continue to take steps to strengthen the alignment of executive and shareholder long-term interests. Among the Top 250 companies, 71 percent disclosed stock ownership guidelines that encourage or require executives to own a specified amount of company stock up from 67 percent last year and 57 percent two years ago. Given that disclosure is voluntary, the actual prevalence of ownership policies may be slightly higher than 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 62 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.

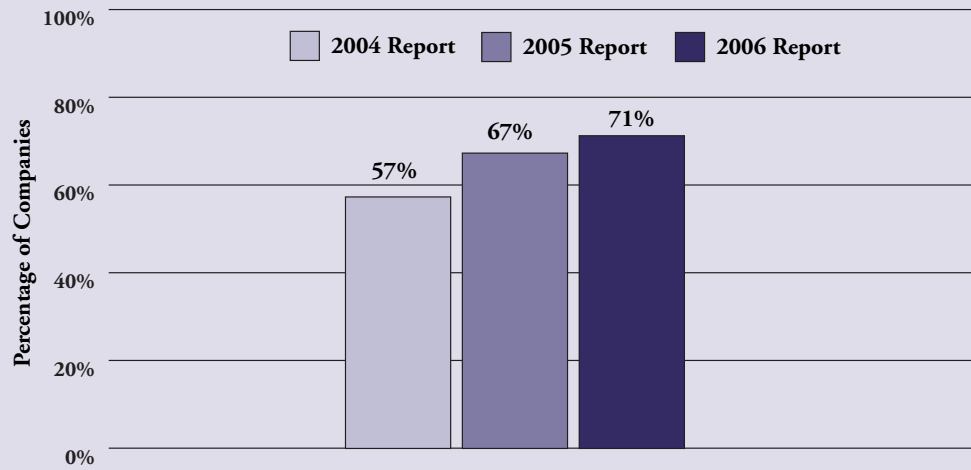
FIXED NUMBER OF SHARES/OTHER – Other guideline approaches are expressed as a number of shares or fixed dollar value and are used by nine percent of companies with guidelines. A fixed-share approach avoids potential issues with a multiple-of-compensation approach where stock price fluctuations can dramatically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

RETENTION APPROACHES – Two general forms of retention approaches are 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 29 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-four percent of companies use a retention approach in combination with another ownership guideline, while five percent use a retention approach as a stand-alone guideline.

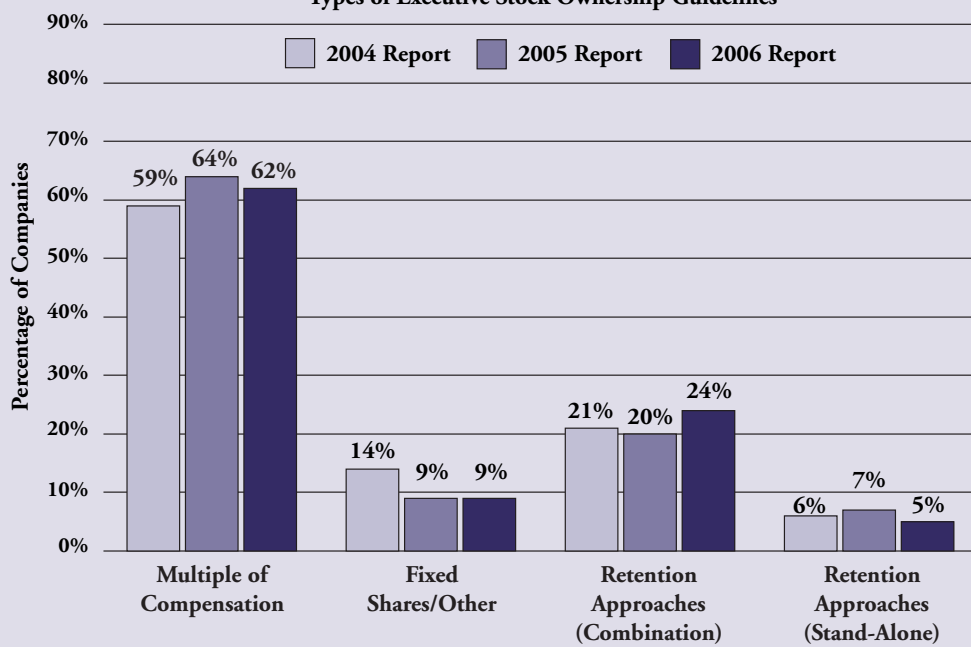
The following exhibits show the prevalence of ownership guidelines at the Top 250 companies, as well as the types of approaches used. Seven percent of companies with guidelines did not disclose the type of ownership guidelines used.

OTHER LONG-TERM INCENTIVE PRACTICES

Prevalence of Executive Stock Ownership Guidelines



Types of Executive Stock Ownership Guidelines



EXECUTIVE LONG-TERM INCENTIVE GRANTS
**SUMMARY OF GRANT USAGE
BY COMPANY**

	Adopted FAS 123	Appreciation		Full-Value		
		Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares
● = Continuing ▲ = New or Prospective Grant Type ○ = Dropped						
3M		●				●
Abbott Laboratories		●		●		
ACE Limited		●		●		▲
Adobe Systems		●				▲
Advanced Micro Devices		●		▲		▲
AETNA		●	▲	▲		●
AFLAC	✓	●		▲		
Agilent Technologies		●				●
Air Products & Chemicals		●		●		●
Alcoa		●		●		
Allergan		●				
Allstate	✓	●		●		●
ALLTEL		●		●		●
Altria Group				●		●
Amazon.com	✓			●		
American Hess		●		●		
American Electric Power					●	
American Express	✓	●		●		●
American International Group	✓	●		●	●	●
Amgen		●				●
Anadarko Petroleum	✓	●		●	●	
Analog Devices		●				
Anheuser-Busch Companies		●		▲		▲
AON		●		●		▲
Apache	✓	▲	●	●	●	
Apple Computer		●		●		
Applied Materials		●		▲		
Archer Daniels Midland	✓	●		●		
AT&T	✓				●	
Automatic Data Processing		●		●		
Avon Products		●		●		●
Baker Hughes		●		●	○	▲
Bank of America	✓	●		●		
Bank of New York	✓	●		●		
Baxter International		●		●		
BB&T		●				●
Bear Stearns	✓	●		●		
Becton Dickinson	✓	○	▲	●	●	
BellSouth	✓			●	●	
Best Buy		●		▲	●	▲
Biogen Idec		●		●	▲	
Boeing	✓	▲		○	○	▲

EXECUTIVE LONG-TERM INCENTIVE GRANTS
**SUMMARY OF GRANT USAGE
BY COMPANY**

	Adopted FAS 123	Appreciation		Full-Value			
		Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares	Performance Units
		● = Continuing ▲ = New or Prospective Grant Type ○ = Dropped					
Boston Scientific		●		▲			
Bristol-Myers Squibb		●		●		●	
Broadcom		●		▲			
Burlington Northern Santa Fe		●		●		●	
Burlington Resources		●		●		●	
CA	✓	●		●		●	
Campbell Soup		○		●		▲	
Capital One Financial	✓	●		●			
Cardinal Health		●		●			▲
Caremark Rx		●					
Carnival		●		●			
Caterpillar		●		●			●
CBS		●		▲			
Cendant		○		●		●	
Chevron	✓	●				●	
Chubb	✓			●		●	
CIGNA	✓	●		●	●		●
Cisco Systems		●					
Citigroup	✓	●		●			
Clear Channel Communications		●		●			
Coach		●		●			
Coca-Cola	✓	●				●	○
Colgate-Palmolive		●		●		●	●
Comcast		●		●			
ConocoPhillips	✓	●				●	
Corning		●		●			
Costco Wholesale	✓	●					
Countrywide Financial		●		●	●		
CSX		●		●			●
CVS		●		●			●
Danaher		●		●		●	
Deere		●		●			●
Dell		●					●
Devon Energy		●		●			
The Walt Disney Company	✓	●		●		●	
Dominion Resources		○		●	●		▲
Dow Chemical	✓	●		●		●	
E.I. du Pont de Nemours	✓	●		●		●	
Duke Energy				●	●	●	
eBay		●					
Edison International		●				●	
Electronic Arts		●					

EXECUTIVE LONG-TERM INCENTIVE GRANTS
**SUMMARY OF GRANT USAGE
BY COMPANY**

	Adopted FAS 123	Appreciation		Full-Value			
		Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares	Performance Units
		● = Continuing ▲ = New or Prospective Grant Type ○ = Dropped					
Electronic Data Systems		●		○		▲	
EMC		●		●	●	▲	
Emerson Electric	✓	●				●	
Entergy	✓	●				●	
EOG Resources		●		●			
Equity Office Properties		●		●		▲	
Equity Residential	✓	●		●		●	
Exelon		●				●	
Express Scripts		○	▲	▲	○	▲	
ExxonMobil	✓			●			●
Freddie Mac		●		●			
Federated Dept. Stores		●		●		●	
FedEx		●		●			●
Fifth Third Bancorp	✓		●	●		●	
First Data		●			●		●
FirstEnergy				●		●	
Ford Motor	✓	●		●		●	
Forest Laboratories		●					
FPL Group	✓	●		●		●	
Franklin Resources		●		●		●	
Gannett		●		●		▲	▲
Gap		●		●			
General Dynamics		●		●			
General Electric	✓	●		●		●	●
General Mills		●		●			
Genworth Financial	✓	●	●	▲			●
Genzyme		●					
Gilead Sciences		●					
Golden West Financial		●					
Goldman Sachs Group	✓	●		●			
Halliburton		●		●			●
Harley-Davidson	✓	●			▲		
Harrahs Entertainment		●		●	●		
Hartford Financial Services	✓	●		●		●	
HCA		●		●			
H.J. Heinz		●		●	●		▲
Hewlett-Packard		●		●			●
Home Depot	✓	●		●			●
Honeywell International		●		●			●
Illinois Tool Works	✓	●		●			
Ingersoll-Rand		●		●			
Intel		●		▲			

EXECUTIVE LONG-TERM INCENTIVE GRANTS

SUMMARY OF GRANT USAGE BY COMPANY

	Adopted FAS 123	Appreciation		Full-Value		
		Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares
● = Continuing ▲ = New or Prospective Grant Type ○ = Dropped						
International Business Machines	✓	●		●		●
International Game Technology		●		●		
International Paper				●		●
Johnson & Johnson		●		▲		
Johnson Controls	✓	●		●		●
J. P. Morgan Chase	✓	●	●	●		
Kellogg		●		●		●
KeyCorp	✓	●		●		●
Kimberly-Clark		●		●		●
Kinder Morgan				●	●	
Kohl's	✓	●		●		
Kroger		●		●		▲
Lehman Brothers Holdings	✓	●		●		
Eli Lilly & Company	✓	●				●
Lockheed Martin	✓	●		●		●
Loews Corp		●				
Lowe's Cos	✓	●		●	▲	
Lucent Technologies		●				●
M & T Bank	✓	●				
Marathon Oil	✓	●	○	●		○
Marriott International		●	▲	●		
Marsh & McLennan	✓	●		●		▲
Masco	✓	●	●	●		
Maxim Integrated Products		●				
McDonald's	✓	●		●		●
McGraw-Hill		●				●
McKesson		●		●		●
Medco Health Solutions		●		●		
Medtronic		●		●		●
Mellon Financial	✓	●		●	●	▲
Merck		●		●		●
Merrill Lynch	✓	●	○	●		▲
MetLife	✓	●				●
Microsoft	✓			●		●
Monsanto Company		●				●
Moody's	✓	●		●	●	
Morgan Stanley	✓	●		●		
Motorola		●		●		●
National City	✓	●		●		●
Network Appliance		●		●		
Newmont Mining		●		●		
News Corp		●		▲		

EXECUTIVE LONG-TERM INCENTIVE GRANTS
**SUMMARY OF GRANT USAGE
BY COMPANY**

	Adopted FAS 123	Appreciation		Full-Value			
		Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares	Performance Units
		● = Continuing ▲ = New or Prospective Grant Type ○ = Dropped					
Nike		●					●
Norfolk Southern		●		●	▲	●	
North Fork Bancorporation		●		●			
Northrop Grumman		●				●	
NUCOR		●				●	
Occidental Petroleum	✓	●	●	●		●	
Omnicom Group		●		●		●	
Oracle		●					
Paychex		●					
J. C. Penney		●		●			
PepsiCo	✓	●				●	
Pfizer		●		●		●	
PG&E		●		●		●	
Phelps Dodge		●		●			
PNC Financial Services	✓	●		○		●	
Praxair		●					
Principal Financial	✓	●		○		▲	
Procter & Gamble		●		●			●
Progressive	✓			●		●	
Prologis		●		●		●	
Prudential Financial	✓	●		●		●	
QUALCOMM		●					
Qwest Communications		●		▲			
Raytheon				●		●	
Regions Financial		●		●	●		
Reynolds American	✓					●	●
Rockwell Automation		●		●		▲	
Sara Lee				●		●	
Schering-Plough		●		●		●	●
Schlumberger	✓	●		▲			
(Charles) Schwab		●		○			●
Sears Holdings	✓	●		●		○	▲
Sempra Energy		●				●	
Simon Property Group	✓			●			
SLM		●		●		●	
Southern Co		●					●
Southwest Airlines		●					
Sprint Nextel	✓	●		●			▲
St. Jude Medical		●					
St. Paul Travelers	✓	●		●		▲	
Staples		●		●	○	▲	
Starbucks		●					

EXECUTIVE LONG-TERM INCENTIVE GRANTS
**SUMMARY OF GRANT USAGE
BY COMPANY**

	Adopted FAS 123	Appreciation		Full-Value			
		Stock Options	SARs	Restricted Stock	PARSAPs	Performance Shares	Performance Units
		● = Continuing ▲ = New or Prospective Grant Type ○ = Dropped					
Starwood Hotels & Resorts Worldwide		●		●	●		
State Street	✓	●	▲			●	○
Stryker		●					
Sun Microsystems		●					
SunTrust Banks	✓	●		●	●		●
Symantec		●					
SYSCO		●					●
Target	✓	●				●	
Texas Instruments	✓	●		●			
Time Warner		●		●		▲	
Transocean	✓	●				●	
TXU	✓					●	
Tyco International	✓	●		●		▲	
U. S. Bancorp	✓	●					
Union Pacific		●		●		●	
United Parcel Service	✓	●		●		●	
United Technologies	✓	○	▲			▲	
UnitedHealth		●					●
Valero Energy		●		●		●	
Verizon Communications	✓			●		●	
Viacom		●		●			
Vornado Realty Trust		●		●		▲	
Wachovia	✓	●		●			
Walgreen		●		●			
Wal-Mart Stores	✓	●		●		●	
Washington Mutual	✓	●		●		●	
Waste Management		○		●		●	
Weatherford International	✓	●		●			
Wellpoint		●		●			
Wells Fargo		●					
Weyerhaeuser		●					
Williams Companies		●		●		●	
Wm. Wrigley Jr. Company		●		●		●	
Wyeth		●				●	
Xerox				●		●	
XL Capital	✓	●		●			
XTO Energy		●					
Yahoo!		●		●		●	
Yum! Brands	✓	●					
Zimmer Holdings		●				▲	

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*.

DEFINITION OF LONG-TERM INCENTIVE GRANT TYPES

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 percent 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 earnings or 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 historically were 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 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.

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