



Change-in-Control Agreements in the New Decade

Compensation Series

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Pearl Meyer & Partners
Comprehensive Compensation[®]



ADVANCING EXEMPLARY BOARD LEADERSHIP



Meet the Presenters



Paula Cholmondeley (moderator), Director at Terex Corporation, DENTSPLY International. Inc., Albany International, and Minerals Technologies, Inc. She is also the CEO of The Sorrel Group, LLC



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Overview



- **Moving into the New Decade for Executive Pay**
 - **CIC Plans – a historical view**
 - **Major influences on CIC provisions and agreements in 2010**
- **2009 Proxy Revelations**
 - **CIC payments and agreements among the Top 50 US-based companies**
- **2010 Trends**
 - **Trends in CIC design from 2009/2010 publicly filed amendments for 105 Fortune 500 companies**
- **Looking Ahead to 2011**
 - **Survey results for 2011 and expected actions**
- **What We're Seeing**
- **How will Dodd-Frank impact CIC Pay?**





Moving Into the New Decade



▪ The Business Case for CIC Plans

<i>The Business Case</i>	<i>The Competing View</i>
<ul style="list-style-type: none">➤ Help align the interests of management with shareholders<ul style="list-style-type: none">– Keep an executive objective in the wake of a takeover or sale of the Company– Without them, management may be more likely to resist valid offers out of fears of losing their jobs➤ Make it easier to hire and retain executives<ul style="list-style-type: none">– Especially in companies or industries more prone to mergers and acquisition➤ Assures payment of previously promised compensation and benefits	<ul style="list-style-type: none">➤ Executives have a fiduciary responsibility to the Company<ul style="list-style-type: none">– Should not need additional compensation to perform their duties in the wake of a CIC➤ In all companies there is a risk of termination and executives are generally well compensated without them➤ Large CIC payments may entrench management, deter buyers, or divert purchase price dollars from shareholders to the benefit of management

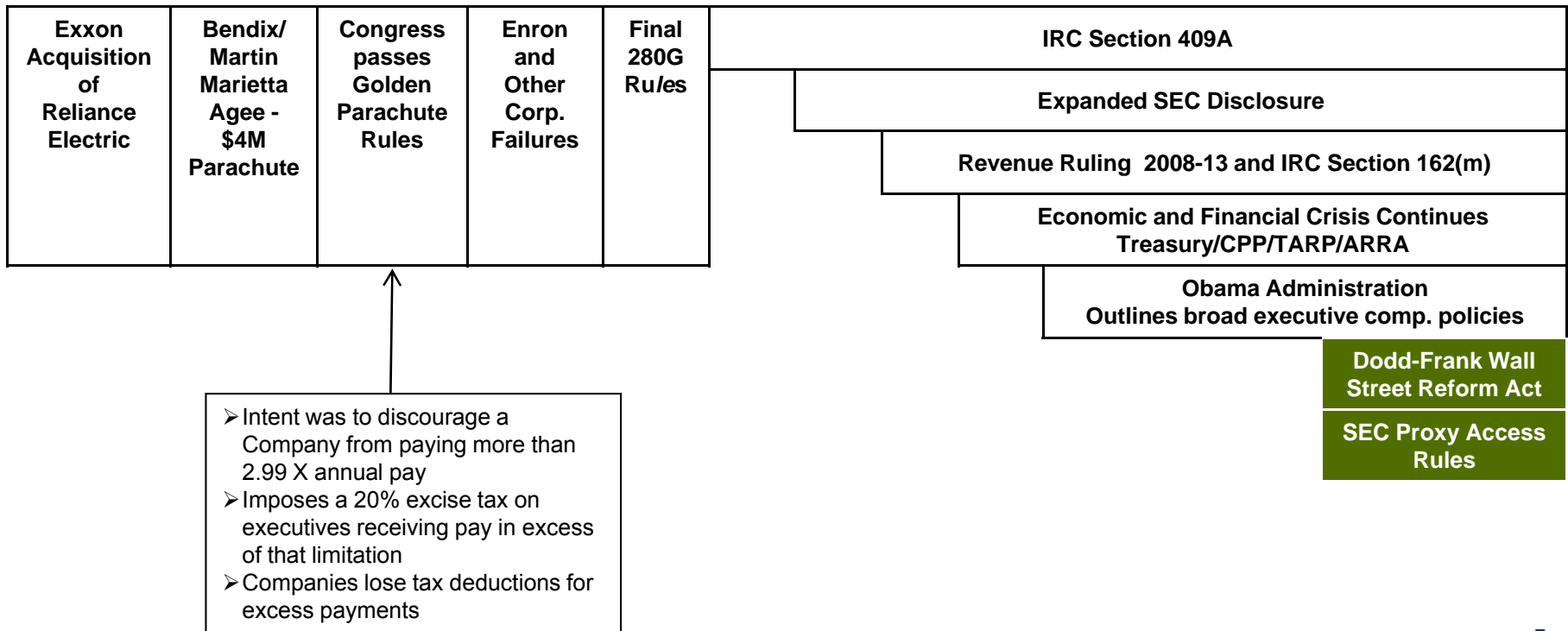




Moving Into the New Decade (Cont'd)



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Moving Into the New Decade (Cont'd)



2010 Environment			
Shareholder Activism	Shareholder Advisory Influence (ISS, Glass Lewis)	Dodd-Frank Wall Street Reform Act Signed into Law 7/21/10	SEC Proxy Access Rules August 2010
<ul style="list-style-type: none"> ➤ Increased proposals related to executive compensation and board governance including: <ul style="list-style-type: none"> • Limitations on golden parachute and severance arrangements, • Adoption of anti-gross-up policies • Adoption of double trigger equity plans ➤ Advisory votes on pay ➤ Move from plural voting to majority voting for director elections 	<ul style="list-style-type: none"> ➤ Increased influence and power to drive shareholder votes (stock plans, Say on Pay, and director elections) ➤ 2010 ISS guidelines identify “problematic pay practices” in CIC plans: <ul style="list-style-type: none"> • CIC payments exceeding 3 times salary and bonus • Single triggered CIC payments • New or materially modified employment or severance agreements with excise tax gross-ups or “walkaway” provisions • Practices may trigger withhold votes on directors or votes against equity plans 	<ul style="list-style-type: none"> ➤ Say on Pay/Say on Golden Parachutes ➤ Disclosure (Pay for Performance, Ratio CEO/Employee, Chairman/CEO Standards) ➤ Independence Standards (Compensation Committee/ Consultant) ➤ Clawbacks ➤ Elimination of broker discretionary voting for uninstructed shares 	<ul style="list-style-type: none"> ➤ Certain eligible shareholders may have their nominees included in the proxy ballot ➤ Only shareholders that hold at least 3% of voting securities are permitted ➤ Shares must be held continuously for three years

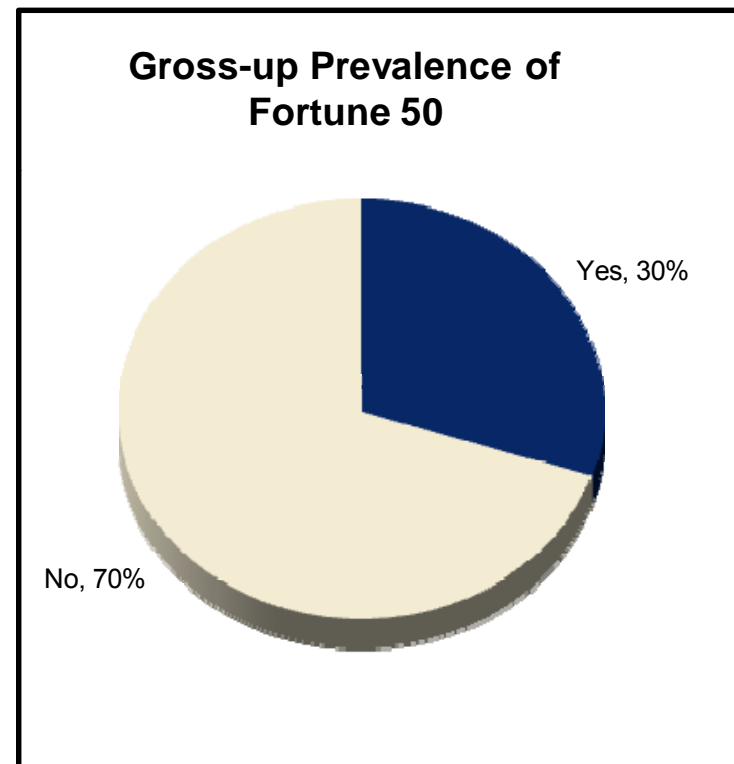
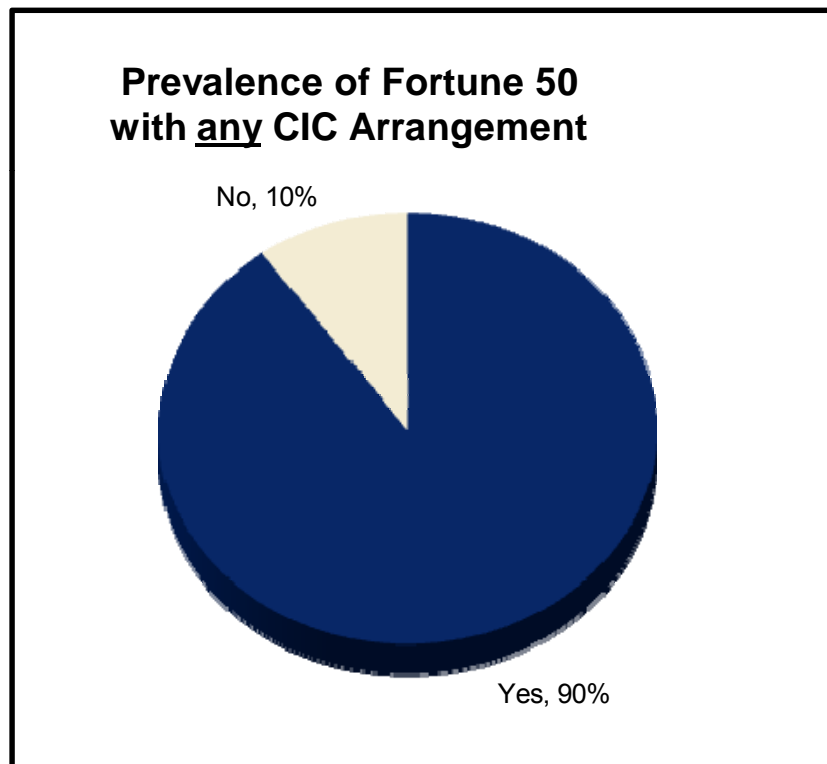




2009 Proxy Revelations



- A majority of the Top 50 U.S. Companies provide benefits upon a CIC and 30% provide excise tax gross-up provisions

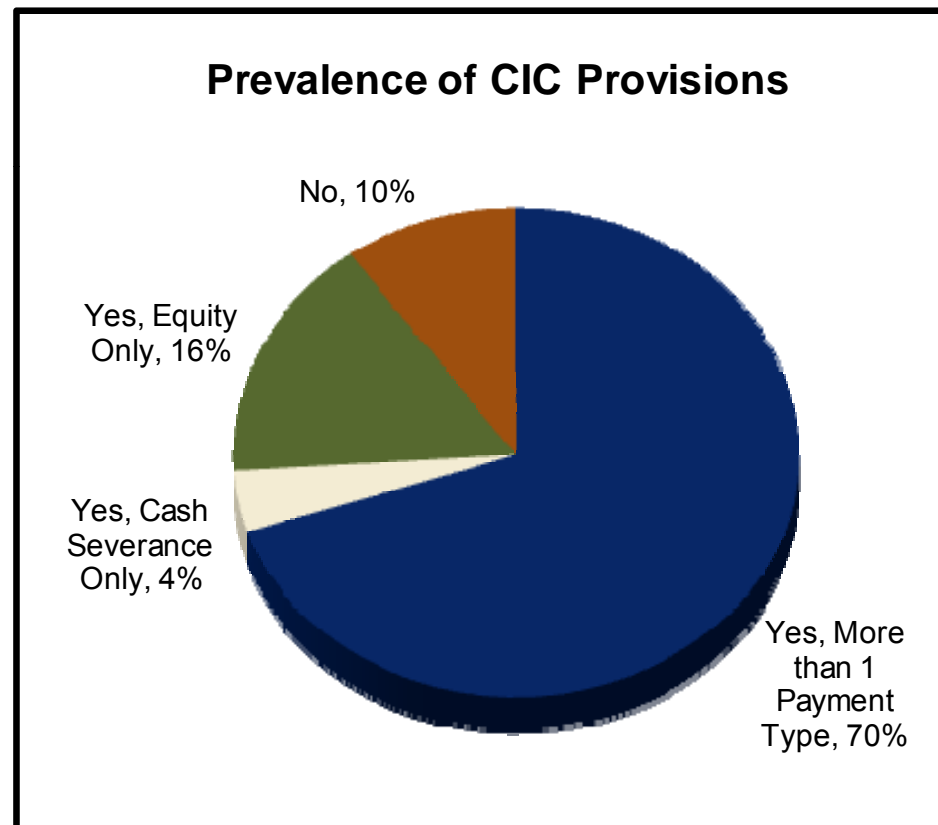




2009 Proxy Revelations (Cont'd)



- The majority of Top 50 companies provide equity vesting accompanied by at least one other form of payment or benefit



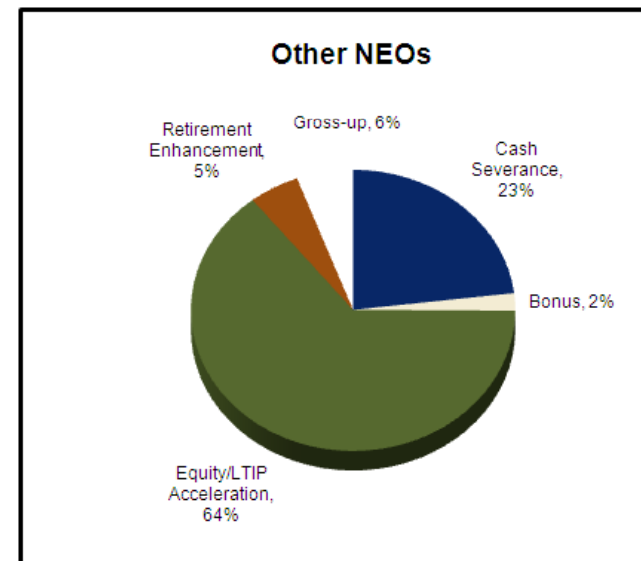
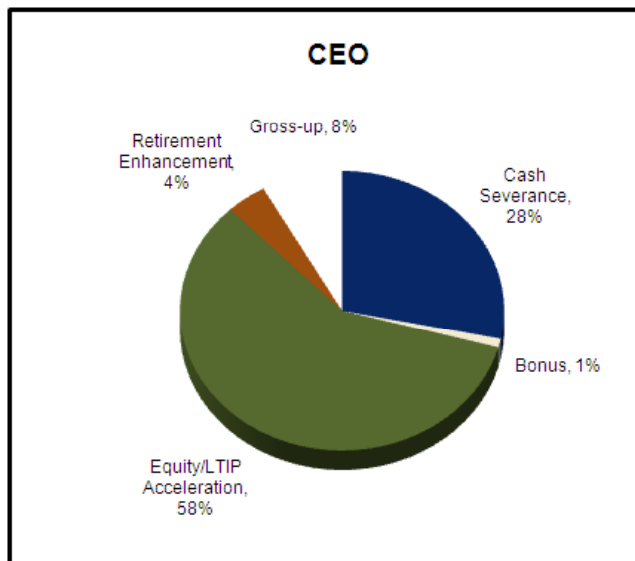


2009 Proxy Revelations (Cont'd)



- When paid, the value of accelerated equity and cash severance was the most significant component

Average Payout By Component



- On average, the proportion of individual types of payments between CEOs and other NEOs is very similar. However, CEOs tend to receive larger cash severance and excise tax gross-ups as a percentage of total payments than other NEOs

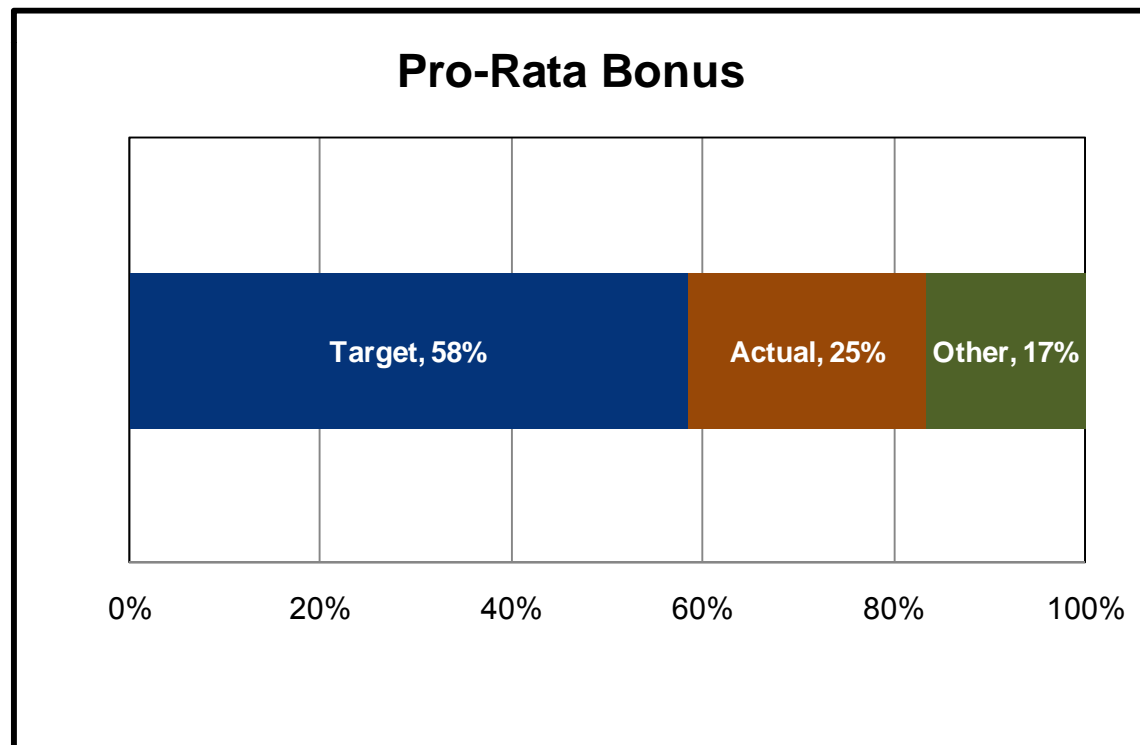




2009 Proxy Revelations (Cont'd)



- **Performance Awards at CIC for Top 50 - Annual Bonus for Termination Year**
 - 76% did not report a bonus for the year of termination – but this may be due to reporting on the last day of the performance cycle
 - If reported, the most prevalent approach was to disclose a pro-rated target bonus

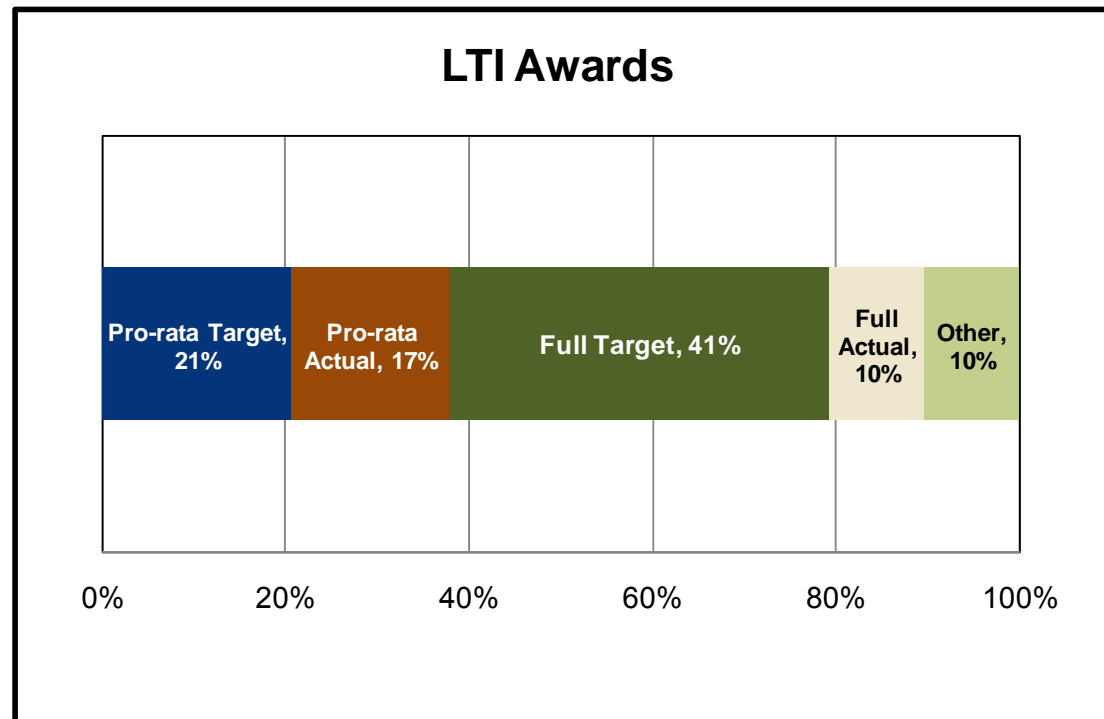




2009 Proxy Revelations (Cont'd)



- **Performance Awards at CIC for Top 50 - Long-term Incentive (LTI) Awards**
 - 42% of the companies did not vest or payout mid-cycle LTI awards upon a CIC
 - 58% indicated a payout may be possible
 - Paying a target payout for the entire award was the most prevalent approach reported





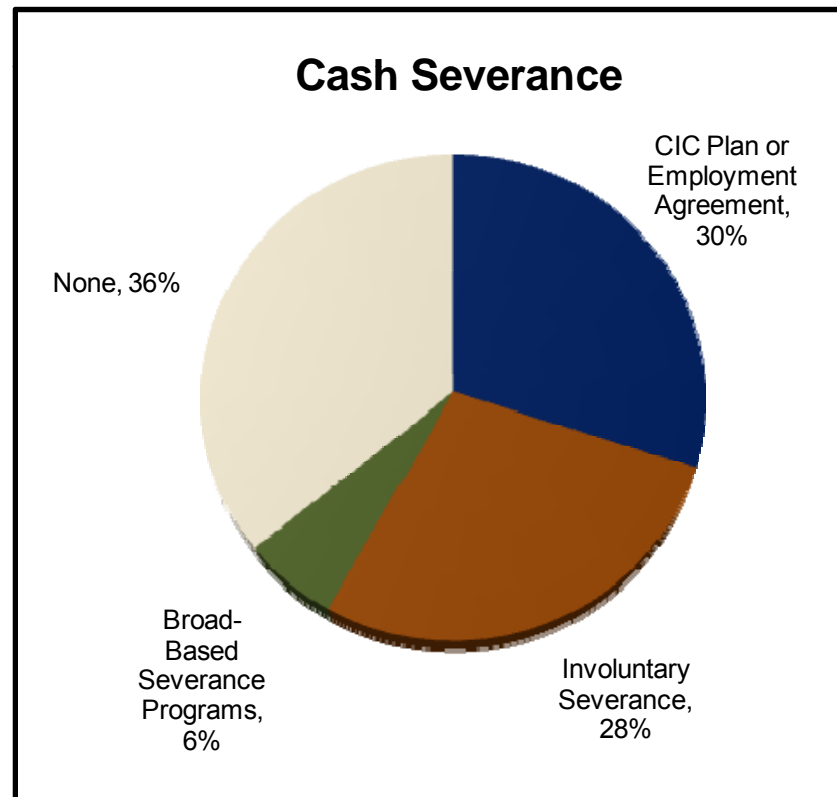
2009 Proxy Revelations (Cont'd)



▪ Cash Severance Programs for the Top 50

➤ Cash severance is provided through a variety of different types of severance programs

- 36% reported no cash severance to the NEOs as their company's most prevalent approach; some NEOs are covered through broad-based severance plans
- Companies paying severance for involuntary termination rather than for CIC emphasize this

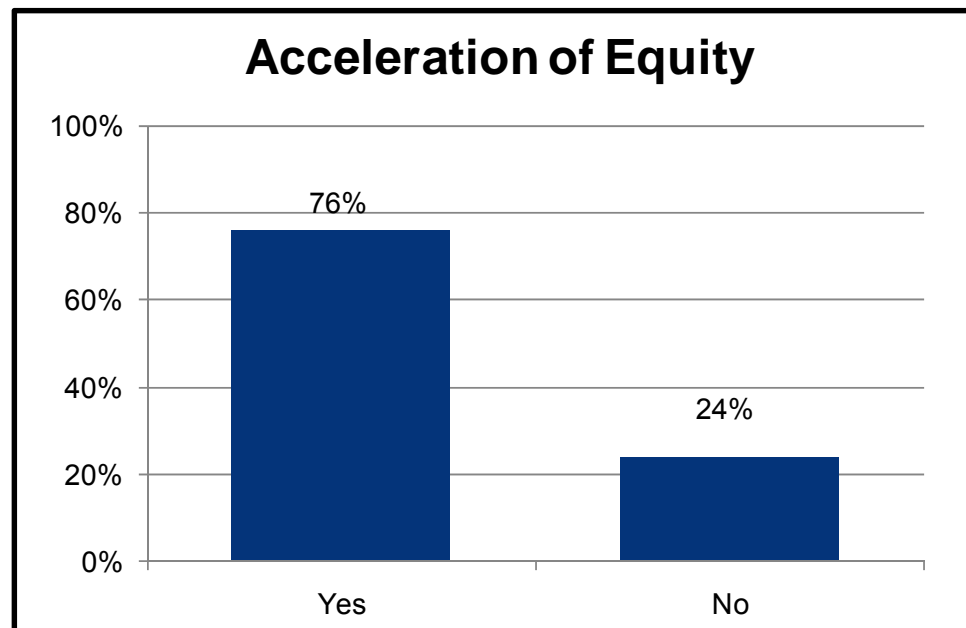




2009 Proxy Revelations (Cont'd)



- **CIC Equity Acceleration among Top 50**
 - The majority of companies provide for acceleration of equity upon a CIC (single trigger) or termination following a CIC (double trigger)
 - Although 24% of companies reported no acceleration tied to a CIC, for some, other termination provisions could accelerate equity awards
 - 8% reported no CIC vesting but awards would accelerate upon retirement
 - 2% reported no CIC vesting but would accelerate if involuntarily terminated

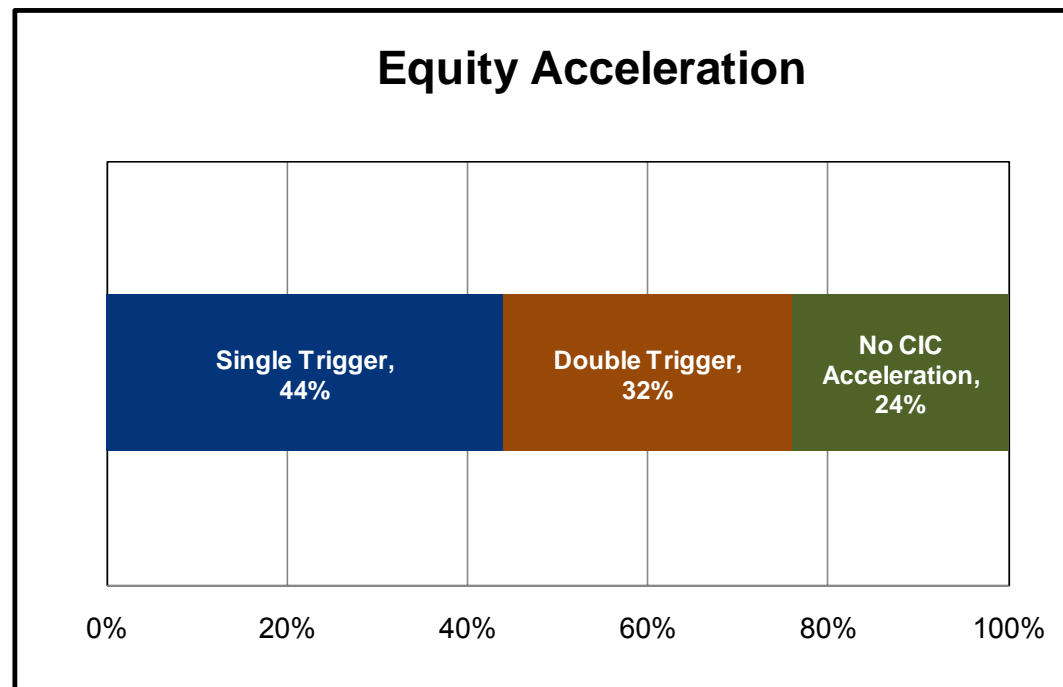




2009 Proxy Revelations (Cont'd)



- **CIC Equity Acceleration among Top 50 (Cont'd)**
 - For companies with CIC acceleration provisions, single trigger vesting is the most prevalent approach
 - There appears to be a movement to implement double trigger provisions
 - Sixteen percent (16%) of companies have moved to double trigger acceleration over the past three years for some form of equity





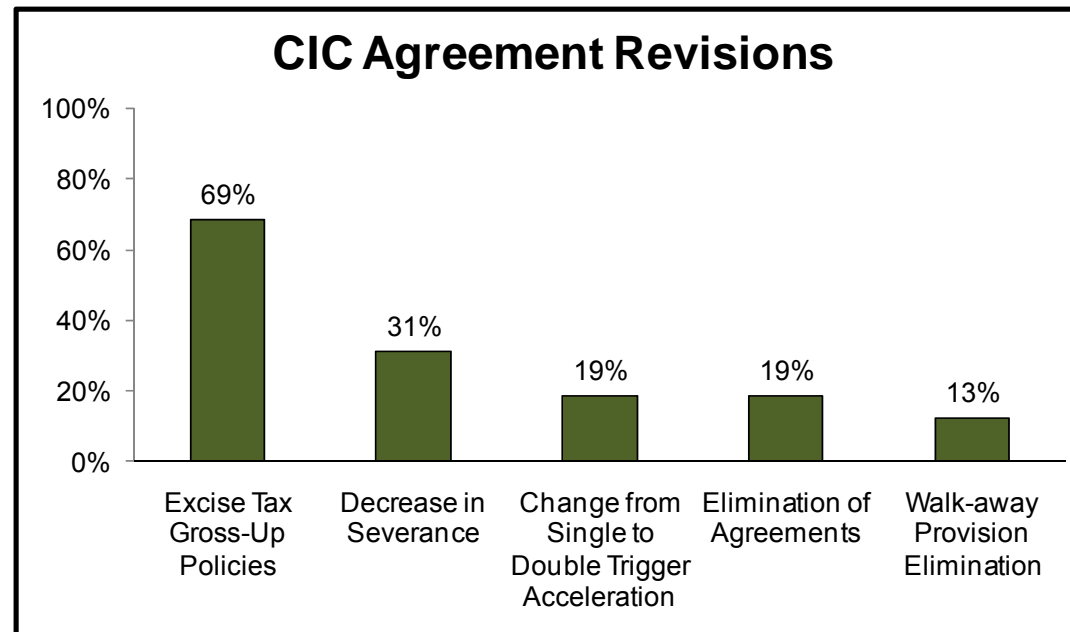
2009 Proxy Revelations (Cont'd)



▪ Trends in the Top 50 – 2009/2010 Revisions to CIC Agreements

➤ 32% have made changes to agreements or policies covering CIC agreements

- Changes in excise tax gross-up policies
- Decrease in severance, such as a change in the multiple
- Change from single trigger to double trigger acceleration
- Elimination of CIC Agreements or employment agreements
- Elimination of walk-away provisions allowing an executive to voluntarily leave following the CIC and receive cash severance





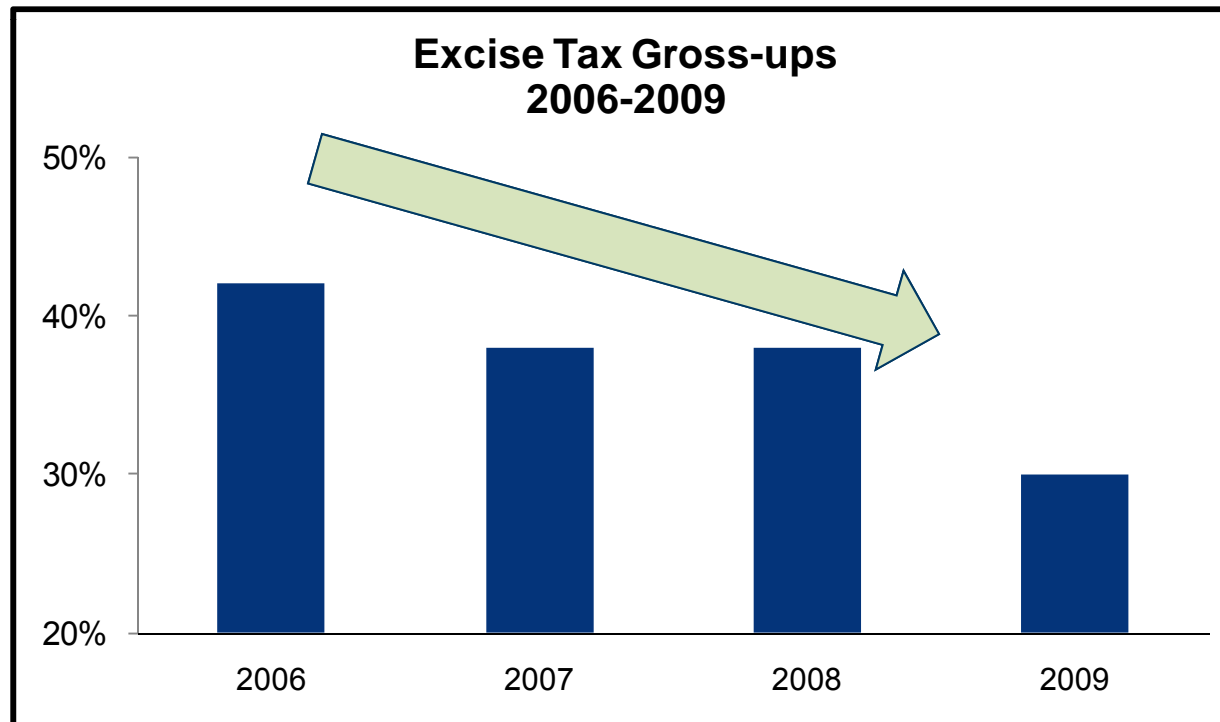
2009 Proxy Revelations (Cont'd)



- **Trends in the Top 50 (cont'd)**

- **Excise Tax Gross-Up prevalence is diminishing**

- At the end of 2006, 42% of the current Top 50 companies reported having excise tax gross-up provisions
 - However, as of 12/31/2009, only 30% of the Top 50 have these provisions





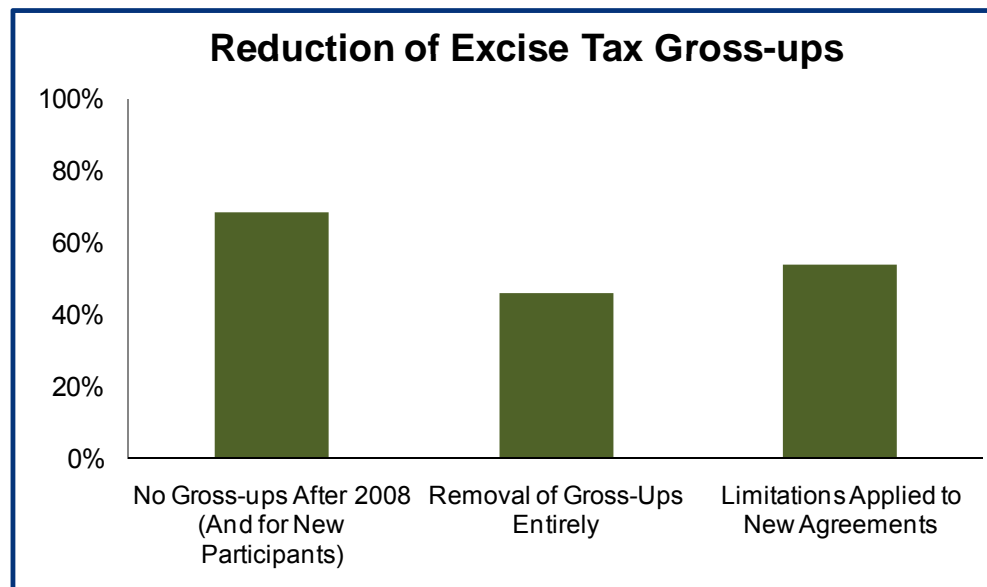
2009 Proxy Revelations (Cont'd)



▪ Trends in the Top 50 (cont'd)

➤ A significant number of the companies with excise tax gross-up provisions have recently announced they will limit these provisions:

- 68% of the companies with excise tax gross-up provisions in 2008 announced that they will either eliminate gross-ups altogether or they will not provide gross-ups to new participants
- 46% of the companies that announced changes removed gross-up provisions from existing agreements
- 54% indicated the change would apply to new agreements
- Some of the companies removing the gross-up provisions from existing agreements announced a delayed effective date

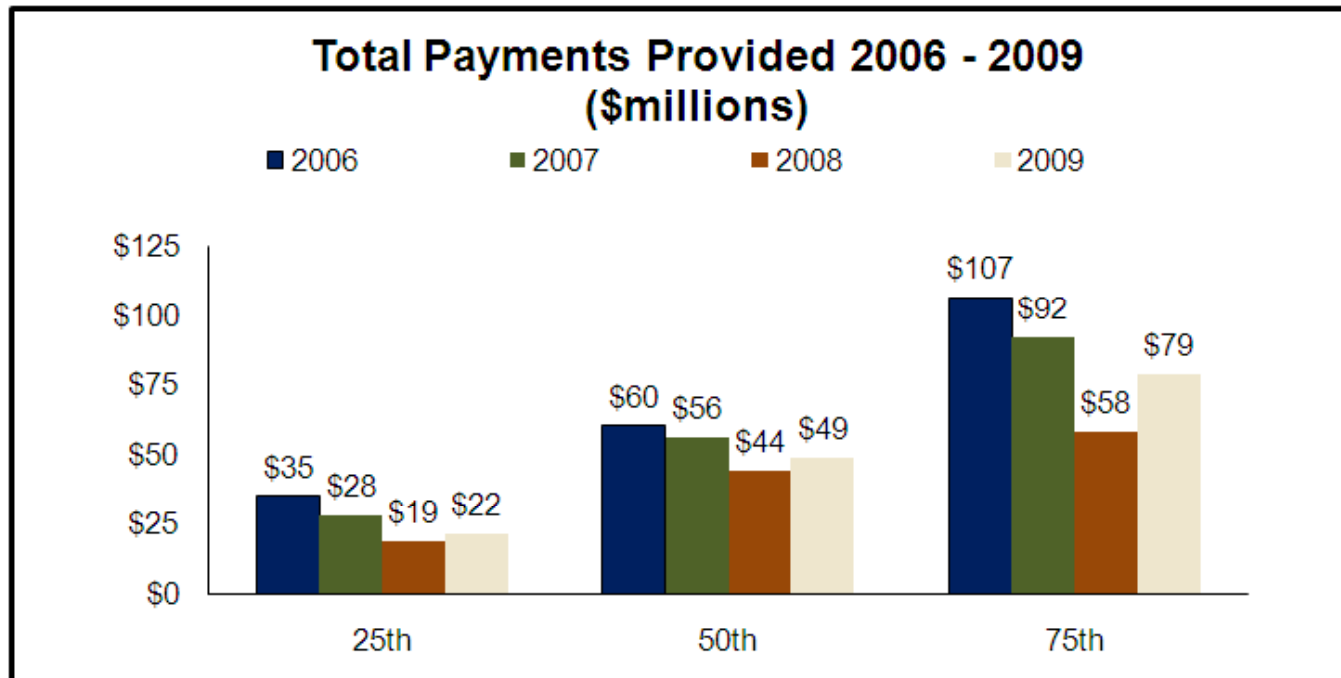




2009 Proxy Revelations (Cont'd)



- **Resulting Trends in CIC payments (2006-2009)**
 - Estimates decreased from 2006 to 2008 due to decreases in stock prices and the elimination or restructuring of certain CIC provisions by some companies
 - Rebounding stock prices in 2009 resulted in an increase in CIC estimates



Note: Data in 2006 is based on 44 of the 50 companies which were required to file under the new disclosure regulations.





2009/2010 Trends



- **PM&P identified 105 Fortune 500 companies that made material modifications to CIC agreements or plans in 2009 and 2010**
 - 43 employment, 54 CIC plans/agreements, and 8 severance plans were reviewed and compared to a company's previously filed agreements of a similar type
- **Agreement Terms and Protection Periods**
 - Term: Remains two to three years where provided
 - Post CIC Protection Period: Typically is 2 years
- **Restrictive Covenants**
 - Over half of the agreements continue to include non-compete and/or non-solicitation provisions for an average of 1.5 years following termination
- **Good Reason Definitions**
 - There was little change in the way the agreements define a "good reason" termination that would entitle an executive to CIC severance benefits





2009/2010 Trends (Cont'd)



■ CIC Severance Formulas

➤ Basis:

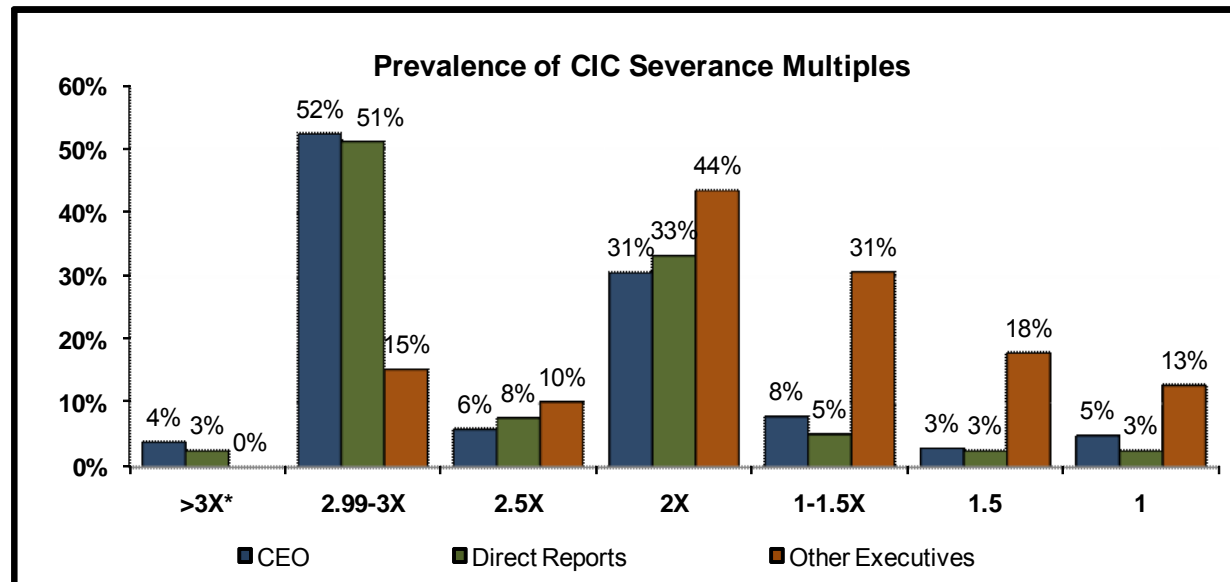
- The majority of companies (over 80%) use base salary and annual incentive; 14% use base salary only; only 2% of the companies use long-term incentives in the severance basis

➤ Multiples:

- The most common severance multiple for a CEO /Direct Reports is 2.99X to 3X and 2X for others

➤ Payment Form:

- Companies primarily pay CIC severance in lump sums (80%)



* Multiples in excess of 3X are a multiple of base salary.





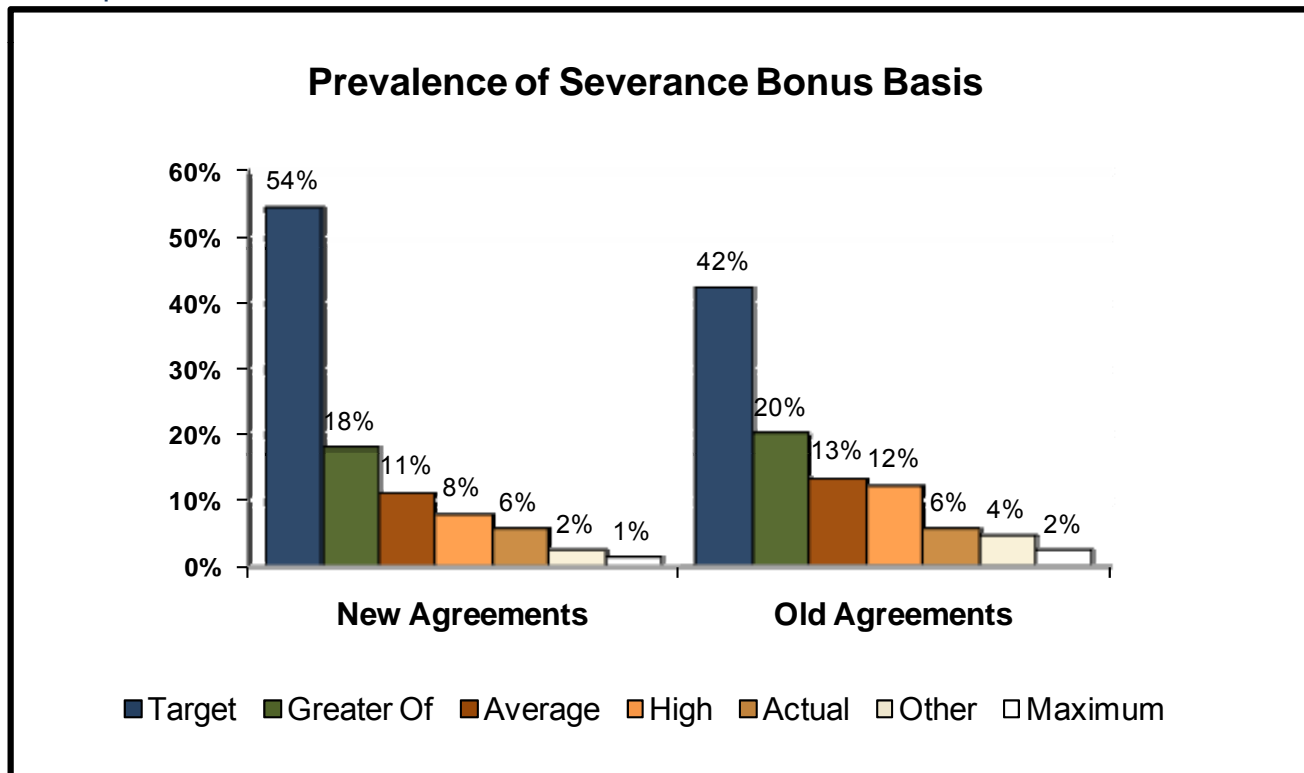
2009/2010 Trends (Cont'd)



■ CIC Severance Formulas

➤ Annual Incentive Component of Severance:

- Target bonus opportunity is most often used
- There was a significant shift to the use of target annual incentive in lieu of other definitions and a movement away from more executive-friendly definitions, such as the maximum opportunity or highest paid bonus





2009/2010 Trends (Cont'd)



■ Involuntary Severance Formulas

➤ Basis:

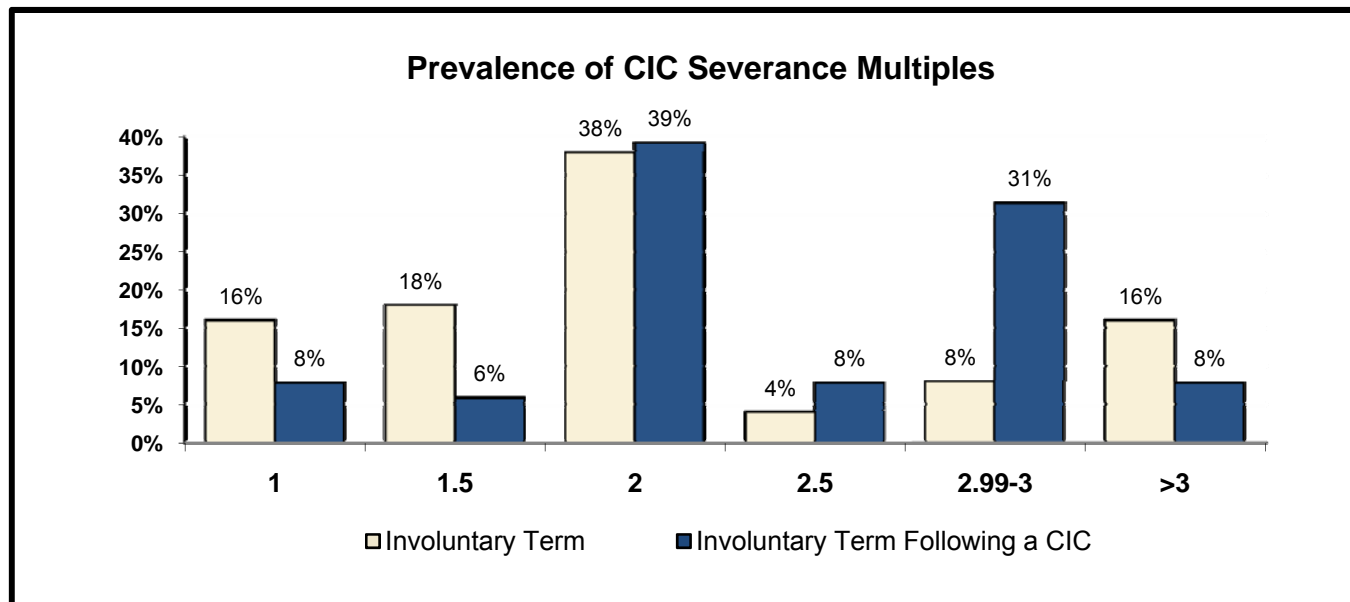
- Although use of base salary and annual incentive is the most prevalent approach for determining severance without regard to a CIC, the prevalence is lower than for CIC (67%); 33% use base salary

➤ Multiples:

- Involuntary termination multiples are generally lower than in a CIC

➤ Payment Form:

- Companies primarily pay CIC severance in installments (63%)



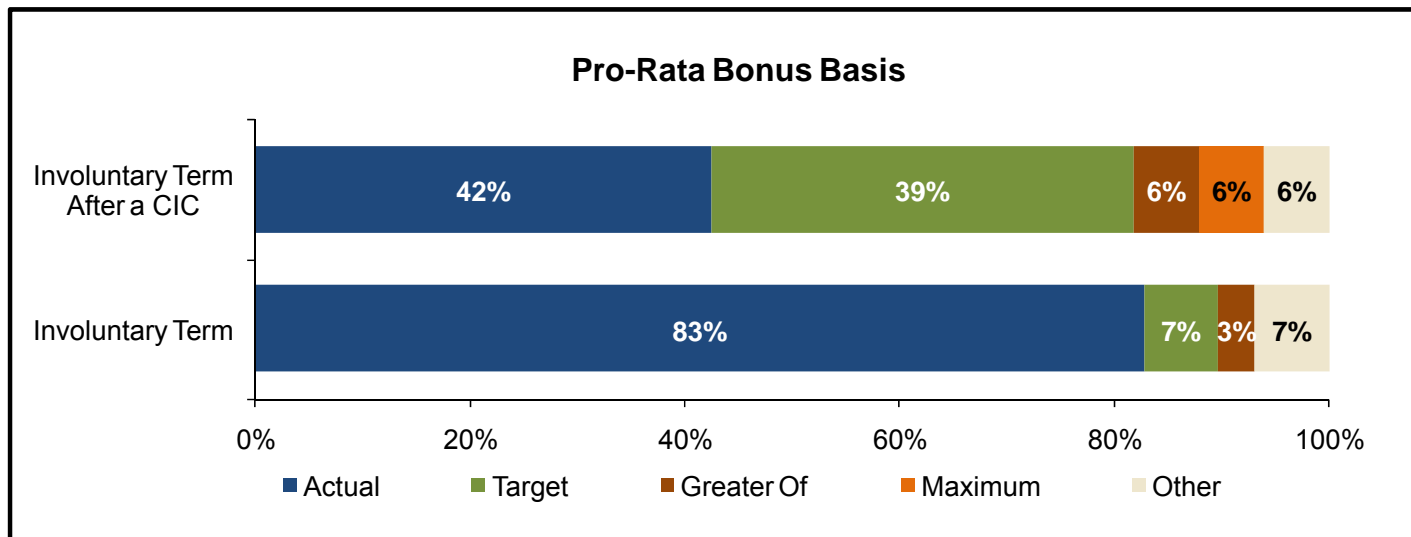


2009/2010 Trends (Cont'd)



▪ Annual Bonus - Termination Year

- The majority of CIC and involuntary termination programs provide for a pro-rated bonus in the year of termination. However, fewer companies provide this for involuntary termination (CIC – 75% - Involuntary Term - 57%)
- For CIC:
 - Bonus is most often based on the target opportunity in the year of termination (57% of the agreements) and paid at termination (74%)
- For Involuntary Termination:
 - Bonus is primarily based on actual results (83%) and paid in the ordinary course of business (92%).
 - A significant number of companies amended contracts to pay based on actual results



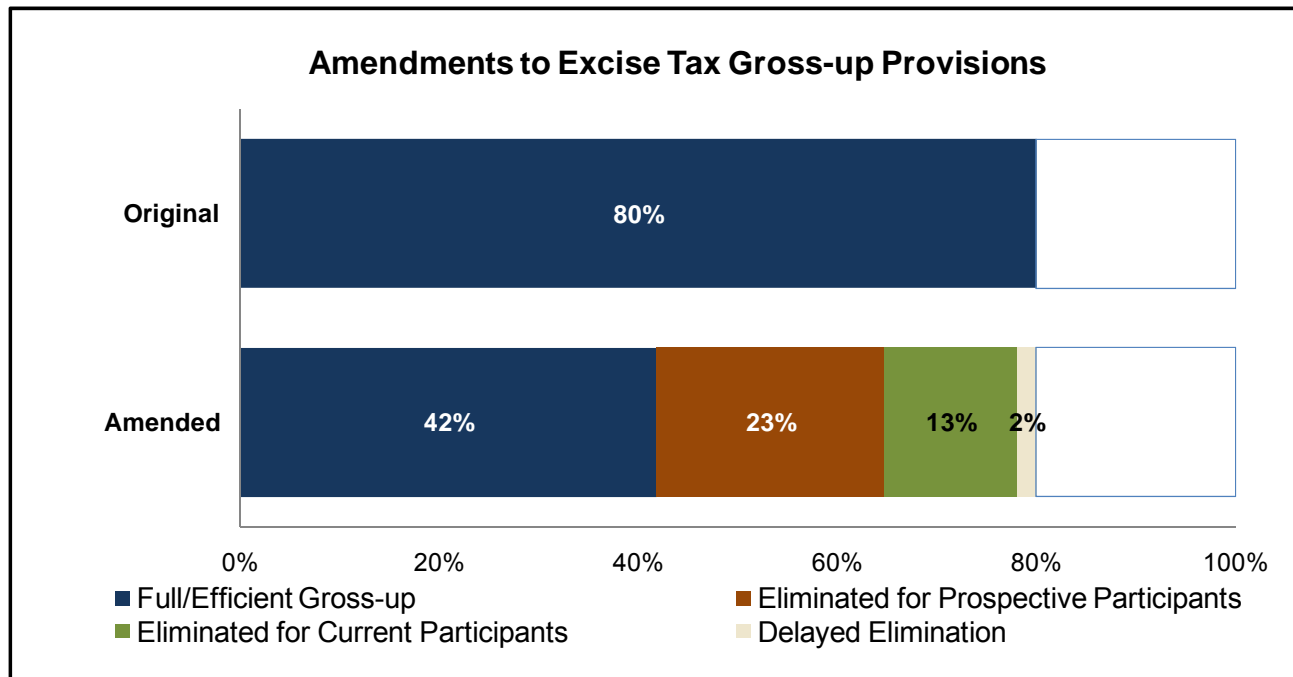


2009/2010 Trends (Cont'd)



▪ Treatment of Excise Taxes

- Over 80% of the agreements/plans we reviewed originally had excise tax gross-up provisions, and over half of these provisions (52%) were modified
- Most of the changes eliminated the gross-up language
 - Most eliminations applied prospectively to new participants
 - Some companies eliminated the excise tax gross-ups entirely for both new and existing participants
 - » Of these companies, a few provided for a delayed effective date of the amendment



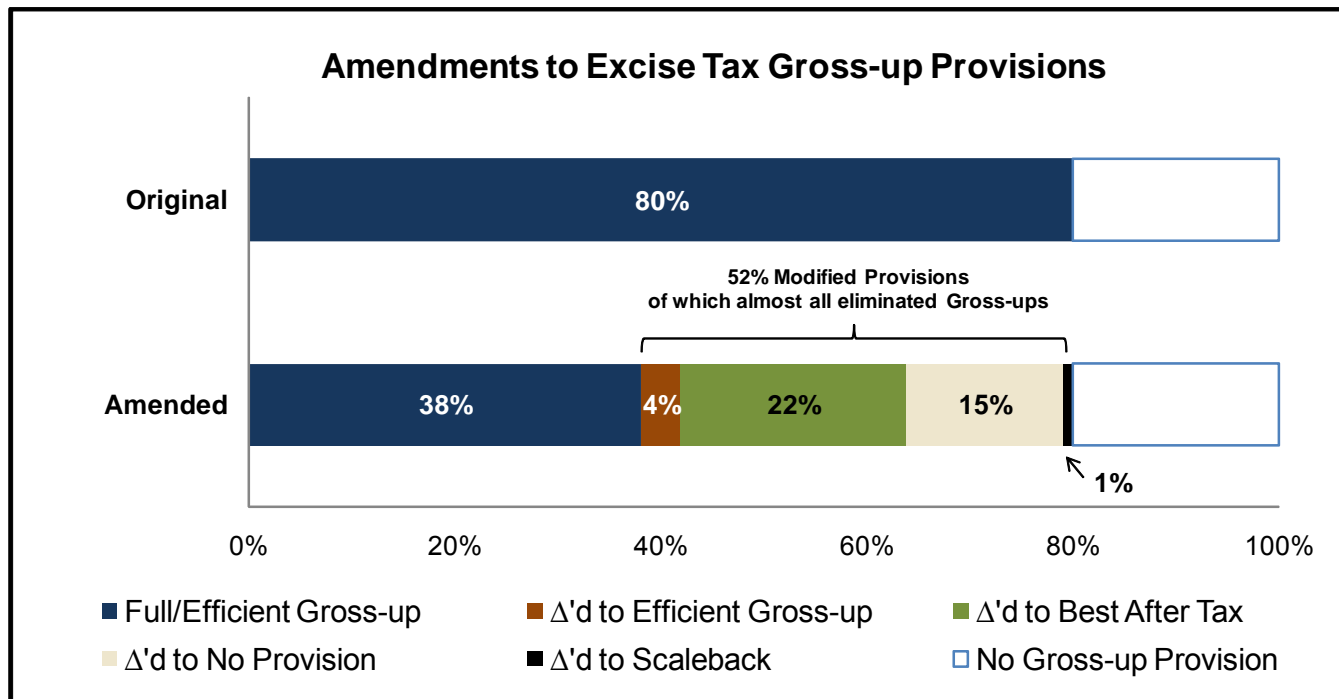


2009/2010 Trends (Cont'd)



▪ Treatment of Excise Taxes

- **If excise tax gross-ups were eliminated, companies most often moved to a best after-tax provision (i.e., an executive will be scaled back to the golden parachute safe harbor if better off on an after-tax basis)**
 - The next most common approach was to simply remove the provision and remain silent about the excise taxes
 - Very few put in language requiring a reduction to the golden parachute safe harbor





2009/2010 Trends (Cont'd)



- **Walk Away Provisions**

- **Allowing an executive the ability to walk away with CIC severance for any reason following a CIC was not common in the agreements we reviewed**
 - Only 10% of the original agreements provided for this
 - About half of the companies that had these provisions, removed them

- **Benefit Continuation**

- **The most common period for continuing benefits in terminations after a CIC followed the severance period or multiple in the agreement**
- **However, some agreements decreased the period to the 18 month COBRA continuation coverage period**





Looking Ahead to 2011



- **PM&P launched an online survey “Looking Ahead to Executive Pay Practices in 2011” to assess critical executive pay topics, including anticipated changes to severance and CIC plans and benefits.**
 - Overall, severance provisions have been or are expected to be curtailed by 5% - 10% of the companies for each of FY 2009, 2010 and 2011
 - Limited change has or is expected to occur on CIC severance or the treatment of equity acceleration in the event of a CIC
 - **Gross-Up provisions are on the decline:**

Actual / Expected Provisions	FY 2009	FY 2010	FY 2011 - Expected	Change 2009/2011
Full/Modified Gross-up	47%	45%	37%	-10%
Best After Tax /Scaleback	9%	11%	12%	+3%
No Provision	43%	45%	51%	+7%

- **Additionally, 24% of reporting companies anticipate that future hires will likely not receive gross-up provisions**

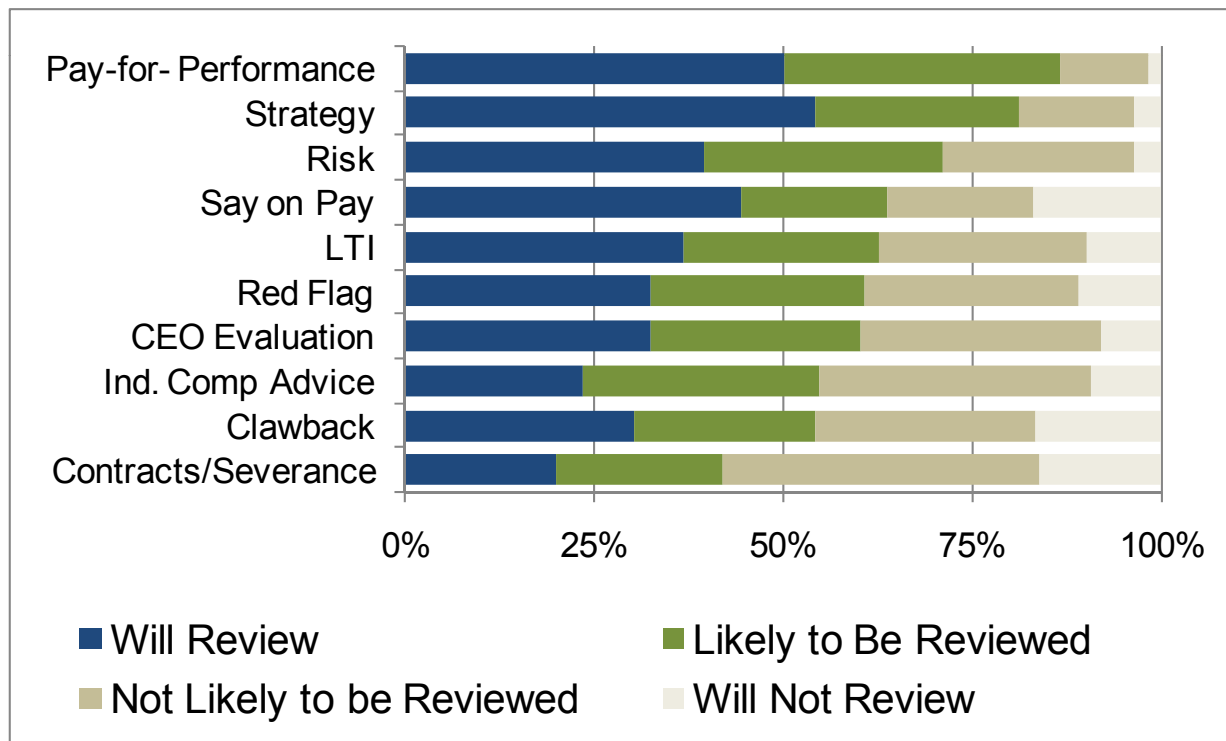




Looking Ahead to 2011



- **Top 10 Compensation Committee Agenda Items**
 - **Pay-for-performance, compensation strategy, and risk remain highest priorities for committees**
 - **Employment contracts, severance, clawbacks and independent advisors are lower priorities for the upcoming year**





What We're Seeing



▪ Severance

- **Multiples of 2X-3X compensation and benefits following a CIC for large company NEOs remain the most common**
 - Some companies have eliminated CIC severance and, instead, pay severance through involuntary termination provisions or plans
 - There is some movement to reduce CIC severance either by reducing multiples or providing benefits through involuntary termination programs
- **Some of the more generous severance provisions are becoming less commonplace. This includes the following practices:**
 - Voluntary “walk-away” provisions following a CIC
 - Multiples in excess of 3x base salary and bonus
 - Use of long-term components when computing severance
 - Use of maximum or highest bonus over a period of years as the bonus component
 - Enhanced retirement benefits
- **A few companies are providing a fixed dollar severance amount (as opposed to a formulaic benefit) in lieu of severance benefits**





What We're Seeing (Cont'd)



▪ Excise Tax Gross-Ups Provisions

➤ New gross-ups for new executives are not common

- Institutional shareholder concern, and identification as one of ISS' problematic pay practices has been a significant driver
- During 2010, if a contract is materially amended, the compensation committee/board members may face negative consequences from ISS or other institutional shareholders if the gross-up provision is maintained

➤ Some companies have been able to provide excise tax gross-ups to new executives in limited circumstances

- In 2010, ISS has allowed a limited exception for new hires if the right to the gross-up includes a sunset provision (i.e. will expire in 3 years or less). It is unclear whether this exception will still be available for meetings for proxy season 2011

➤ Removal of gross-ups from existing contracts is difficult but not impossible

- In our experience, a CEO's support for the removal of the gross-ups has been helpful
- For some, the market downturn has lessened the perception by executives that a significant benefit has been taken away
- Some boards have taken a hard line approach and removed the provisions as the agreements are close to expiration





What We're Seeing (Cont'd)



- **Excise Tax Gross-Ups Provisions**
 - A few companies have elected not to make amendments curtailing other benefits in CIC agreements if they are unable to eliminate the gross-up or other “problematic pay practices”
- **Equity Acceleration**
 - There is a movement for companies to implement double trigger acceleration provisions in new agreements
 - However, single trigger acceleration remains the most common approach





How Will Dodd-Frank Impact CIC Pay?



- **Say on Pay**
 - With Say on Pay now effective in 2011, we would expect Boards to continue to evaluate CIC plans and provisions
 - Coupled with other recent corporate voting changes, Board members may be more influenced by institutional shareholder and shareholder advisory views about CIC practices
- **Say on Golden Parachutes**
 - **It is unclear if approval of CIC practices during an annual meeting (along with regular Say on Pay) will actually save companies from resubmitting to CIC pay to shareholders at the time of a transaction**
 - Further SEC guidance is needed
 - **It is also unclear if Say on Golden Parachutes will have any affect on the behavior of Target companies at the time of a transaction**
 - At the time of an impending deal, Boards are more likely to face retention issues with their executives, increasing the need for CIC programs
 - Target's compensation committee members would not typically be continuing on as Board members, so they may not be as sensitive to a threat of negative votes





Key Definitions / Terms



▪ Golden Parachute and Excise Tax Basics

- When an executive's CIC related payments exceed the safe harbor, the value that exceeds the base amount is subject to a 20% excise tax
 - Base Amount – the average of the executive's last five years' taxable income from the company (typically Box 1, W-2 wage income) prior to the CIC
 - Safe Harbor – value of the three times the Base Amount less \$1

▪ Gross-up

- This is an additional payment made by a company to cover an executive's excise taxes
- Full Gross-up – covers all excise taxes and any income and excise taxes. Intended to leave the executive whole for any excise taxes imposed
- Efficient Gross-up – if parachute payments are more than a specified percentage or amount over the safe harbor, a gross-up is provided, if not, the excess is scaled back to the safe harbor

▪ Scaleback

- A reduction in payments to the amount of the safe harbor
- When scaled back, there are no excise taxes





Key Definitions / Terms (Cont'd)



- **Best After-Tax**
 - The company reduces the CIC payments to the safe harbor only if the executive is better off on an after-tax basis (considering income taxes and excise taxes)
- **Single trigger vs. Double trigger**
 - **Single trigger** – refers to any vesting or payment that occurs strictly because the CIC took place
 - **Double trigger** – refers to vesting or payments that occur following a CIC and termination from the company

