



***Report to the New York Stock Exchange
on Investigation Relating to the
Compensation of Richard A. Grasso***

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I. INTRODUCTION: SCOPE OF INVESTIGATION AND REPORT

On September 23, 2003, the New York Stock Exchange, Inc. ("NYSE") retained Dan K. Webb and Winston & Strawn LLP to investigate the facts and circumstances relating to the compensation and benefits awarded by the NYSE to Richard A. Grasso during his tenure as Chairman and Chief Executive Officer of the NYSE between 1995 and 2003.

We specifically were asked to investigate the process and reasons behind the levels of compensation and benefits awarded to Grasso during the period 1995-2003, and to examine the facts and circumstances surrounding Grasso's employment contract executed on August 27, 2003, pursuant to which Grasso received a payout in September 2003 of approximately \$139.5 million in deferred compensation and benefits and was to receive additional scheduled payments of about \$48 million in deferred compensation and benefits from 2004 through 2007. We also were asked to determine whether the levels of Grasso's compensation and benefits during this period were reasonable, and what effects these levels of compensation and benefits had on the NYSE. We were asked to complete our inquiry into these matters (the "Investigation") in approximately two months and prepare a written report summarizing our findings.

We began our investigation on September 24 and completed it during the second week of December. In connection with the Investigation, we conducted more than sixty interviews and gathered and reviewed thousands of pages of documents. Those we interviewed included Grasso, members of the NYSE's Human Resources Policy and Compensation Committee ("Compensation Committee" or "Committee") during Grasso's tenure as Chairman and CEO, members of the NYSE's Board of Directors ("Board") at the time the Board approved Grasso's 2003 employment contract on August 7, 2003, various NYSE staff involved in the NYSE compensation process and related issues, and various outside consultants and lawyers who were involved in the NYSE's compensation process. Attached as Exhibits 2 and 3 are a list of the witnesses interviewed and a list of the Board and Committee members from 1995-2003.

To assist in analyzing issues relating to Grasso's compensation, we retained the services of three respected experts in the area of executive compensation: Alan M. Johnson of Johnson Associates, Inc.; Fredenc W. Cook of Frederic W. Cook & Co., Inc.; and Brian T. Foley of Brian Foley & Co., Inc. Each provided expert analysis supporting the findings and analysis in this Report regarding Grasso's compensation.

This Report summarizes the relevant information regarding Grasso's compensation and benefits that we have learned in the course of our Investigation.¹ In addition, we have set forth an analysis of whether the levels of Grasso's compensation and benefits were reasonable, which is supported by the analysis of our compensation experts. We also have provided an analysis of the reasons and factors that contributed to the levels of Grasso's compensation and benefits, as well as a brief summary of the impact of the levels of Grasso's compensation on the NYSE. Finally, we have provided some recommendations for changes in the NYSE's compensation process.

¹ While many whom we requested to interview were interviewed and provided information, we were unable to interview former Committee member Linda Wachner due to scheduling issues. Other witnesses imposed time constraints or other limitations on interviews or refused to answer certain questions, limiting to some extent the information we were able to gather. Thus, there were certain practical and legal limitations on the investigation, including the inability to compel witnesses, including third parties, to answer questions or produce documents.

II. EXECUTIVE SUMMARY OF FINDINGS

Grasso Received Unreasonable Levels of Compensation and Benefits

During his tenure as Chairman and CEO of the NYSE, Grasso received excessive levels of compensation and benefits, far beyond reasonable levels. In total, Grasso received approximately \$144.5 million to \$156.7 million in excessive compensation and benefits. Attached as Exhibit 1 is a chart showing the excess compensation and benefits.

➤ Excessive Compensation

For the eight-year period from 1995-2002, Grasso received more than \$97.8 million in annual compensation, approximately \$81.5 million of which was awarded for the four years **from** 1999-2002. Even assuming that Grasso performed at a consistently outstanding level during this period, his compensation was more than double what was reasonable in this four-year period. Grasso's total in excess annual compensation was approximately \$43.1 million.

For the years 2000 and 2001, Grasso's compensation **was** grossly excessive, approximately three to four times what was reasonable. In those years, his annual compensation reached approximately \$26.8 million and \$30.6 million, respectively. A conservative estimate of what Grasso's yearly compensation should have been in this period is \$4-6 million, based on the median level of an appropriate peer group. Even assuming outstanding performance by Grasso, a generous annual compensation level would have been in the range of about \$8-9 million. Grasso's compensation level was several times that amount for 2000 and 2001.

➤ Excessive Benefits

The level of benefits that Grasso accumulated during this period was excessive by any reasonable standard. By August 2003, before his 2003 employment contract was approved or executed, Grasso's Supplemental Executive Retirement Plan ("SERP") benefit translated into a lifetime annuity of at least \$7.4 million per year, and could have been substantially higher than that depending on various factors. This translated into a total lump sum present value pension benefit in August 2003 of about \$126.4 million. About \$82.9 million of these pension benefits accumulated in the last four years.

Grasso's total level of pension benefits was several times more than what a reasonable pension would have been. Applying appropriate executive compensation analysis and **benchmarking** criteria, an appropriate pension for Grasso would have been in a range of about \$875,000 per year, which would translate into a lump-sum pension benefit of about \$12.8 million. Even under the most favorable analysis and assumptions, Grasso's pension should not have exceeded an annuity of **about** \$2.1 million or a lump sum of more than \$25 million. Accordingly, under his employment contracts with the NYSE, Grasso accumulated total excess pension benefits of between \$101.4 million and \$113.6 million.

Large portions of Grasso's accumulated pension benefits were paid out to Grasso on three separate occasions while Grasso remained employed at the NYSE. First, in June 1995, in connection with the negotiation of his first employment contract as Chairman and CEO, Grasso asked for and received his total accumulated SERP benefits as of that date, a total of about \$6.6 million.

Next, in May 1999, when he signed his second employment contract as Chairman and CEO, Grasso was allowed to transfer from his SERP account to his Supplemental Executive Savings Plan ("SESP") account a total of about \$29.9 million. That amount represented Grasso's total accumulated SERP benefit at that time, excluding: (1) the approximately \$6.6 million in SERP benefits that previously had been paid out to him in 1995; and (2) an amount of about \$5.2 million that Grasso agreed to forego at that time through a change in the mortality table used to calculate his SERP benefit.

Finally, pursuant to his third employment contract as Chairman and CEO, which was executed on August 27, 2003, Grasso was to receive additional SERP benefits, including: (1) an immediate payout of about \$51.6 million in SERP benefits; (2) an immediate payout of the approximately \$29.9 million in SERP benefits that had previously been transferred to his SESP account in 1999 and by August 2003 had grown to about \$33.6 million; (3) a right to additional scheduled payments of SERP benefits totaling about \$28.6 million over four years, from 2004 through 2007; (4) a right to other potential amounts of SERP benefits, depending on various facts and circumstances regarding his employment; and (5) additional payouts of deferred compensation and additional rights to other amounts of deferred compensation. Thus, Grasso not only accumulated excessive amounts of pension benefits, he was allowed to withdraw them repeatedly from his retirement accounts while still employed at the NYSE.

▪ **Grasso's Excessive Compensation and Benefits Were the Result of a Multi-Flawed Executive Compensation Process**

Grasso's excessive compensation and benefits were the product of multiple flaws in the compensation and benefits process employed by the NYSE, including the following:

➤ **Failure to Adequately Design, Monitor, and Oversee Grasso's SERP Benefits**

Grasso's SERP benefits, which were provided to him pursuant to his employment contracts, were not subject to any reasonable limits or caps that would have prevented their growth to unreasonable levels. Further, Grasso's accumulation of SERP benefits was not monitored sufficiently over the years. The Compensation Committee did not examine and consider the level of Grasso's SERP benefits accumulation when making its compensation decisions for Grasso on a yearly basis, and awarded large bonuses to Grasso without fully analyzing the impact of those bonuses on Grasso's accumulation of SERP benefits.

At no time did the Committee examine whether Grasso's SERP benefits accumulation was reasonable or conduct any market or peer group analysis to gauge whether Grasso's SERP benefits accumulation was consistent with the market level or a peer group level of pension benefits. And in 2000 and 2001, when at least some on the Committee became concerned, in a general manner, about the growth of Grasso's SERP benefits accumulation, the Committee did not take sufficient action to analyze or determine what the precise accumulation was, or what the precise effect of further large bonuses for Grasso would be on his SERP benefits accumulation. The Committee also approved of several payouts and transfers of Grasso's SERP benefits while he was still employed at the NYSE, effectively turning a pension into a cash compensation device.

To rectify these problems, the NYSE should consider implementing caps or limits on SERP benefits accumulation, eliminating or revising the jump-sum option for SERP benefits, and requiring that the Compensation Committee, as part of its yearly analysis of compensation for senior management, review

and consider the benefits to which such executives are entitled and monitor their accumulation of SERP benefits.

9 Faulty Mechanics/Process Used to Determine Grasso's Yearly Compensation

The process by which Grasso's annual compensation was determined was flawed in many respects. The Compensation Committee used an inappropriate comparator group for benchmarking Grasso's compensation levels, comparing Grasso to CEOs of large, profit-making institutions that are vastly different from the NYSE. Such organizations are much larger than the NYSE in numerous key respects including revenue, net income, number of employees, assets, and other factors, making them inappropriate companies to use in benchmarking Grasso's compensation. The Committee also obtained only incomplete data about the comparator group it used and then used that data in unconventional ways to create unreliable and inflated benchmarks for Grasso's compensation. Further, the Committee arbitrarily departed upwards from its own inflated benchmarks, in some years awarding Grasso more than twice those benchmarks.

To address these problems, the NYSE Compensation Committee should reevaluate and improve its process for benchmarking executive compensation, and should have consultants play a more substantive role in the executive compensation process.

9 Lack of Appropriate Involvement of Consultants in Connection with Grasso's Compensation and Benefits

The consultants employed by the Compensation Committee did not have the appropriate level of involvement in, or input regarding, the compensation and benefits process. Consultants performed no analysis of Grasso's SERP benefits accumulation to examine whether it was reasonable or consistent with the market, and did not analyze whether Grasso's contractual SEW benefits, or the NYSE's SEW, should be subject to caps or other limitations so that the benefits remained at reasonable levels.

The consultants also were not sufficiently involved in, and therefore did not attempt to correct, the flawed process employed by the Committee in making its annual compensation decisions for Grasso, including the Committee's use of an inappropriate comparator group and faulty benchmarking formulas and the Committee's unreasonable compensation awards for Grasso that were well above the benchmarking in some years.

As noted directly above, compensation experts should be more substantively involved in the executive compensation process at the NYSE.

9 Lack of Transparency/Disclosures Regarding Compensation

Only a handful of people knew about Grasso's pension accumulation, and Grasso's compensation awards were not disclosed outside the Board. Many Board members agreed that, had Grasso's compensation and benefit levels been disclosed outside the Board, they would never have reached such excessive levels. Annual disclosure of top executive compensation, which the NYSE already has implemented under its newly adopted corporate governance practices, should address this issue.

➤ **Lack of Continuity/Dedication on Compensation Committee/Board**

The NYSE's large Board during Grasso's tenure as Chairman and CEO, coupled with the high level of turnover of Board and Committee members from year to year and the failure to adequately train and share historical NYSE knowledge with new Board and Committee members, may have created an environment that was conducive to overcompensation. The high turnover and lack of training caused a lack of continuity on the Committee and the Board, which resulted in Board and Committee members not having a complete frame of reference for executive compensation decisions. The large Board led to at least some on the Board feeling less responsibility or less accountability for executive compensation decisions, and caused them to give complete deference to others on those matters.

The smaller NYSE Board created after Grasso resigned should be helpful in addressing this issue. In addition, going **forward**, close attention should be paid to training new Board and Committee members and **providing** them with important historical information relating to executive compensation.

➤ **Grasso's Control Over the People and Processes that Determined His Compensation**

Against proper governance practice, Grasso was involved in or connected to the process that determined his own compensation. For example, he personally selected which Board members served on the Compensation Committee, and some directors he selected were those with whom he had friendships or personal relationships. He also had a strong influence on who was appointed to the Board, which approved the compensation awards that the Committee recommended for him each year. In addition, Grasso determined, in his discretion, the "Chairman's Award" component of the annual NYSE performance evaluation process, which the Committee used in part to determine the annual bonus awards for NYSE employees generally, as well as to benchmark Grasso's own compensation.

The issues concerning selection of Board members and Committee members have now largely been addressed through the newly revised structure of the NYSE's Board and Compensation Committee. The Chairman should not select members of the Compensation Committee. The Committee should adopt procedures by which, in the future, the "Chairman's Award" is not used directly to create benchmarks for, or actual awards of, the CEO's compensation.

The Approval of Grasso's 2003 Employment Contract Was Based on Incomplete and Inaccurate Information and Was Made Without Adequate Deliberation

Grasso's **2003** contract was approved by the Compensation Committee and the Board based on incomplete and **inaccurate** information. Despite being presented with information to the contrary, a number of the Committee members who voted to recommend the **2003** contract to the Board incorrectly believed that the payout of approximately \$139.5 million to Grasso under that contract resulted in terminating all of Grasso's future benefits under SERF and the NYSE's Capital Accumulation Plan ("CAP"). In fact, the contract provided for \$48 million in scheduled future payments of SERP benefits, CAP benefits, and deferred compensation, and also provided that additional SERF benefits could be paid out in the future under certain circumstances.

The entire Committee also believed, incorrectly, that the \$139.5 million payout to Grasso under the contract was fully vested. In fact, his right to approximately \$13 million in CAP benefits that were part of the \$139.5 million had not **yet** vested, and was not scheduled to vest until 2005.

The Committee members failed to advise the Board of some of the essential terms of the proposed contract, including the \$48 million in scheduled future payments under the contract, the potential additional SERP benefits that possibly could accrue under the new contract, and the payment of \$13 million in unvested CAP benefits. In fact, the Committee gave the Board **contrary** information, leading the Board to believe there were no future payments under the contract.

Finally, neither the Committee nor the Board conditioned its approval of the proposed contract on an actual review of a written contract, which had not been drafted at the time the Board voted on the proposed contract. Instead, the Board approved of the proposed contract in concept based on unclear and incomplete term sheets and oral discussions. The contract ultimately was signed by the **Committee** Chairman without being fully reviewed.

Grasso's Excessive Compensation and Benefits Have Had a Detrimental Impact on the NYSE

Grasso's excessive levels of compensation and benefits have negatively affected the NYSE in at least three fundamental ways. First, the large amounts of excess **compensation** and benefits have had a negative impact on the **NYSE's financial** capability to serve its purposes. At the time of his resignation in September 2003, Grasso had been paid about \$43.1 million in excessive compensation. Also as of that time, Grasso had received payments of more than \$88 million in pension benefits (valued at \$95.1 million with interest on earlier payments considered), and approximately \$70.1 million to \$82.3 million of that amount was excessive. Thus, Grasso received **from** the NYSE in the range of \$113.2 million to \$125.4 million in excess compensation and pension benefits. The NYSE could have used that money to serve its interests and purposes in a variety of ways, including for the benefit of its members, its listed companies, or the investing public.

Second, Grasso's excessive compensation and benefits have had a detrimental impact on the brand and goodwill of the NYSE. Unquestionably, the firestorm that has surrounded Grasso's excessive compensation and benefits has, to some extent, tarnished the reputation and image of the NYSE. As a result, the NYSE is now in the process of **undertaking** to rebuild the trust and confidence of members, investors and listed companies.

Finally, as a result of the excessive compensation and benefits, the NYSE has been required to spend its resources dealing with this issue. NYSE employees and agents have been required to perform a variety of work that they otherwise would not have been required to perform had Grasso not been overcompensated, including being required to respond to an inquiry **from** the Securities and Exchange Commission on matters relating to Grasso's compensation. None of these corporate resources would have been spent in the absence of the **overcompensation**.²

² There are a number of legal issues that the NYSE may wish to consider in light of our investigation and Report. This Report, while providing a summary and analysis of the information and facts gathered in the investigation, does not directly address the legal issues relating to those facts or provide any legal advice or analysis on those issues. We will separately provide the NYSE with legal advice and analysis on issues that the NYSE wishes to consider relating to the matters addressed in this Report.

Importantly, the notion of providing equity-type compensation to NYSE executives was part of the basis used to support the development and implementation of the LTIP and, later, the CAP. These programs provided to NYSE senior executives, including Grasso, additional **bonuses/compensation** (beyond their ICP awards) that were tied to longer-term **service** and **performance**, like stock options. As opposed to stock options, which had risk, the LTIP and the CAP provided no-risk, deferred cash compensation that vested upon the executive attaining certain years of **service** or ages.

In addition, the long-term or equity component of the comparator group executives' compensation was included in the actual and median target compensation levels of the comparator group that the Compensation Committee used in performing its benchmarking analysis each year. Most Committee members we **interviewed** who recalled the **benchmarking** process were aware that the actual and target medians incorporated the comparator group executives' equity type compensation on a Black-Scholes basis. Some, however, expressed criticism of the Black-Scholes methodology for valuing stock options and said that the options often have much greater value than the Black-Scholes methodology would suggest.

4. Compensation Committee Meetings and Board Meetings

As noted above, after Ashen and his staff pulled together the materials for the Compensation Committee to consider in **making** its **compensation** decisions for Grasso and other NYSE employees each year, a series of meetings took place in and around each February at which Grasso's compensation would be discussed and decided. First, Ashen **often** would meet individually with Committee members to share the information he had gathered, including the **ICP** evaluation for the year and the relevant comparator group compensation information. Second, the Compensation Committee would then hold its February meeting. Third, after the Committee meeting, the February Board meeting would be held.

a. Meetings Between Individual Compensation Committee Members and NYSE Human Resources Staff

After the materials were assembled for the Compensation Committee's decisions on compensation each year, and prior to the February **Committee** meeting at which yearly compensation decisions were made, Ashen would coordinate with the Chairman of the **Compensation** Committee and provide the materials to the Committee Chairman for his review.

During the period from 1995-2003, the Committee Chairmen were as follows:

June 1994 -May 1996: Stanley C. Gault
June 1996 -May 1998: Ralph S. Larsen
June 1998 -May 1999: Bernard Marcus
June 1999 -May 2003: Kenneth G. Langone

Ashen said that, typically before the Committee meetings each year, he met separately with the Committee members to present and discuss the relevant compensation materials. Almost all of the members of the Committee during the earlier years of Grasso's tenure did not recall having such meetings with Ashen. However, several (but not all) Committee members who served on the Committee in later years of Grasso's tenure (after about 1999) recalled having such meetings.

Ashen said that, at these meetings, he typically would provide and discuss with Committee members the compensation materials that he and his staff had put together. He said that he did not send out those materials ahead of time to the Committee members, and would not leave copies of the materials with the Committee members, but instead would bring the materials to the individual meetings, allow the Committee members to review them, and discuss any questions or issues that the Committee members raised with him.

Ashen said that he would sit down for a half-hour to **an** hour with each Committee member and he would walk through the presentation that he would also make at the Committee meeting, which included: (1) what happened last year; (2) the NYSE's performance results for that year as shown by the ICP performance evaluation, including the performance factors, the **Chairman's** Award and a narrative of accomplishments; (3) the comparator group; (4) Grasso's recommendation on executive compensation; and (5) a discussion of Grasso's compensation. Again, while Ashen stated that he had these meetings with all or substantially all Committee members each year, many Committee members did not recall having such meetings with Ashen, especially prior to 1999.

Beginning in February 1999 (for 1998 compensation), he provided the Committee members with executive compensation worksheets showing past compensation and benchmarking computations for Grasso, Johnston, Kinney and Britz, and the other top 3-4 senior executives. A separate worksheet was always included for Grasso, and usually the other employees each were the subject of separate worksheets as well, although sometimes certain similarly situated employees, such as Kinney and Britz, would be combined on a single **worksheet**.⁵⁶

Ashen said that he first provided these worksheets to the Committee members during his individual meetings with them prior to the February Committee meeting. Ashen provided Grasso the executive compensation worksheets for the other senior executives in advance of Ashen's meetings with the individual Committee members so that Grasso could provide Ashen his views on the appropriate level of compensation for those executives and Ashen, in turn, could provide Grasso's recommendation on those individuals to the Committee members in his individual meetings with them.

The executive compensation worksheets provided a chart showing the past compensation information for each of the employees, broken out by category (salary, ICP, LTIP), but typically for only the prior year (except in 2003, when the employees' two prior years of compensation were **included**). Although in some years CAP was listed as a separate category in the chart, in other years it was not, but instead was listed only as a footnote to the chart.

The worksheets also listed the actual or target median for the comparator group executives whose job matched the position of the employee at the NYSE under consideration. In addition, the worksheets showed calculations applying the benchmarking formula used in that year, including the discount from the actual or target median and the multiplication of the discounted median by the percentage of target performance achieved by the NYSE that year, pursuant to the ICP performance evaluation process.

Notably, while a number of Committee members in 1999 and later years recalled receiving the executive compensation worksheets in meetings with Ashen prior to the February Committee meeting each year, others recalled seeing the worksheets only at the Committee meetings, and some others did not recall

⁵⁶ See NYSE 054136-42, 054061-64, 053980-86, 053924-28, 012340-43, 042409-11, 044092-93, 043780-81, 046048-51, 012727, 054064, 011201, 013145.

seeing the worksheets at all, even though they were provided in the materials the Committee received and reviewed at the Committee meetings.

Also, some of the executive compensation worksheets that were provided to the Committee (whether at the individual meetings **with** Ashen or at the Committee meeting in February) were not as complete as the worksheets for those executives in those years that Ashen had in his files and used for his own purposes. Specifically, for compensation years 2000 and 2001 (Grasso's two highest compensation years), the executive compensation sheets for Grasso that were provided to the Committee did not have separate columns for CAP and the Total Compensation, but Ashen had separate executive compensation sheets for Grasso in those years in his own files that were identical in all respects to those provided to the Committee except that they included those **columns**.⁵⁷ **Also**, the executive compensation sheet for 2000 did not include any mention of the Special Payment that Grasso received that year.

Ashen said that, during his meetings with the Committee members, he typically would advise the Committee members the level of compensation that Grasso was recommending for all of those under him that the Committee had to consider, including Johnston, **Kinney**, **Britz**, and the few other top executives whose compensation the Committee specifically considered. He said that, in addition, during the years that Langone was Chairman, he would meet with Langone before beginning his series of meetings and would advise the Committee members of Langone's recommendation concerning Grasso's compensation level for the year.

Ashen said that he would sometimes collect feedback from Committee members as to what their reaction was to Grasso's recommendation on the other top executives and Langone's recommendation on Grasso. As he continued on and met with each Committee member separately, he would pass along that information to them so that the Committee members, in advance of the February Committee meeting, would have a sense of where each other stood on the compensation issues. A number of Committee members agreed with Ashen's recollection on this point, while others did not recall being advised by Ashen of a recommendation for Grasso's compensation, or providing Ashen any information or feedback on that issue.

Ashen said that he and Grasso had no discussions at any time about Grasso's compensation, including the benchmarking that applied to Grasso, except for once in 2002 when he mentioned to Grasso what Grasso's benchmark was. Ashen stated that Grasso never provided him with any information **or** any recommendation to pass along to Committee members. Committee members likewise said that they were not aware of Grasso having any direct involvement in his own compensation, or discussing it with any Committee members or Board members. Ashen also said that, when he met with each Committee member, he did not make any recommendation or comments to the Committee members about the appropriate level of Grasso's compensation, but instead simply passed on whatever Langone or others had recommended for Grasso. Committee members who recalled meeting with Ashen agreed.

Ashen and all of the Committee members who recalled meeting with him prior to any February Committee meeting agreed that, in connection with yearly compensation decisions in February, the Committee was not given any materials regarding **SERP**, including the **SERP** accumulation of Grasso or any other NYSE employee, and that **SERP** was not discussed at any of these meetings.

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See NYSE 011598,054064,031794,053980.

b. Compensation Committee Meetings

(i) General Process of Compensation Committee Meetings

At the Compensation Committee meetings each February, the Committee would make its decisions concerning the final compensation to award for the prior year to the NYSE's top executives, including Grasso. Usually, attendees at the meeting included the Committee, Ashen, Grasso, Jeff Hyman of Hewitt, and sometimes Bemstein.

At the meeting, the Committee had before it a packet of materials relating to the compensation decisions it was required to make. These materials distributed included the ICP performance evaluation **summary**, a list of the comparator group, and the executive compensation worksheets for each of the senior executives, including Grasso. Ashen stated that if the Committee members had reached a consensus about Grasso's compensation through their individual meetings with him, the executive compensation worksheet in their materials **would** be in final form and would contain the final compensation numbers for Grasso.

In general, the Committee meeting typically went as follows. First, Ashen presented the results of the NYSE's performance against the targets that had been set for the previous year on the empirical ICP performance criteria. (Ashen stated that he had prepared the narrative on the NYSE's performance based on reports **from** the various divisions of the NYSE, and that Grasso had approved it.) **After** Ashen made his presentation, Grasso would then discuss with the Committee his recommendations for the Chairman's Award, which included a narrative of accomplishments for the year.

Ashen and Grasso then would present the proposed ICP awards for the senior executives. Typically, the Committee focused primarily on the top seven executives at the NYSE in its compensation process. Ashen stated that the level that the Committee decided for compensation of those seven executives to some extent determined the level of compensation for all others in the organization. Ashen stated that he and Grasso reviewed the executive compensation worksheets for senior executives, which contained the benchmark for their compensation. Ashen stated that the Committee used the worksheet as a starting point and would then determine their compensation awards.

After the Committee decided on its awards for senior management, Grasso would leave the room and the discussion turned to his own yearly compensation award. It **appears** that during some years Ashen remained for this discussion while in other years he too left the room. The Committee **Chairman** would typically give the presentation for Grasso's compensation, often with the aid of speaking points prepared by Ashen; sometimes Ashen gave the presentation.

Ashen said that, if the Committee, through the members' individual meetings with him, had arrived at a general consensus regarding Grasso's compensation before the meeting, then he would fill in the boxes for Grasso's compensation on the executive compensation worksheet. In that case, the Committee Chairman would present that number to the Committee and the Committee would accept it without extensive discussion. From the applicable executive compensation sheets, it appears that, in every year from 1998 forward, the numbers in the Grasso worksheet were filled in at the time the worksheet was provided to the Committee, suggesting, according to Ashen, that the Committee was in agreement going into many of the Committee meetings about the compensation for Grasso. The only year the numbers on the worksheets changed as a result of the Committee meeting was in 2002 (for 2001 compensation), when the ICP award was adjusted upward and the proposed Special Payment was correspondingly reduced.,

However, many Committee members recalled considerable discussion each year at the Committee meetings regarding Grasso's compensation level, and generally said that the decision regarding Grasso's compensation was made at the Committee meeting, after discussion and consideration by the Committee as a whole.

Committee members, particularly in later years of Grasso's tenure as Chairman and CEO, were not consistent on the precise subject of their discussion or decision each year concerning Grasso's compensation. In the later years, Grasso's compensation had several components, including an ICP award, an LTIP award, and a CAP award, and in 2000 and 2001, a Special Payment – all in addition to his base salary. Some Committee members in later years recalled that the Committee focused on only some parts of those awards, and may have ignored the CAP award in particular in setting the overall compensation. Others recalled that the total compensation of Grasso was discussed and decided on, and that the individual components were then "backed into" by starting with the total award, subtracting the fixed components (salary and LTIP) and then adjusting the remaining **components(s)** accordingly. When the CAP was in place, the Committee would divide the remainder, 1/3 to CAP and 2/3 to ICP.

Committee members all agreed **that** there was no annual discussion of, or presentation at the Committee meetings relating to, Grasso's **SERP** benefits. Most Committee members said they were aware that Grasso had **SERP** benefits and that the ICP awards would contribute to his **SERP** benefits, but some stated that they never even heard that Grasso had **SERP** benefits. Those directors who **acknowledged** knowing that Grasso had **SERP** benefits were clear, however, that specific information about the level of Grasso's **SERP** benefits accumulation was never provided to the Committee at any time prior to the fall of 2002, when it was provided in connection with the consideration of a new contract for Grasso and a payout of his **SERP** benefits. Thus, neither the amount of Grasso's accumulated **SERP** benefits to date nor the resulting impact of the yearly ICP award on Grasso's **SERP** account were considered at the Committee meetings at which Grasso's recommended yearly compensation award was determined.

(ii) Yearly Compensation Committee Decisional Meetings, 1996-2003

(a) February 1996 (1995 Compensation)

The first time the Committee considered Grasso's annual compensation as Chairman and CEO was in February 1996, for the year 1995. At the time, there was no CAP or LTIP, so the only decision point for the Committee was the level of Grasso's ICP bonus.

According to Stanley C. Gault, the Chair of the Committee at that **time**, the same factors initially considered by the Committee in determining Grasso's bonus amount were: (1) his target bonus (\$700,000, as set by his 1995 contract); and (2) the performance of the NYSE which, as **determined** by the ICP performance **evaluation**, was 130% above its target level. Gault stated that, because the NYSE's performance level was above the target, the **Committee** would have considered awarding Grasso a bonus above Grasso's \$700,000 target ICP bonus.

Gault noted that the Committee did not use any comparator group or formula to determine Grasso's bonus or to compute a benchmark for his bonus, but instead the Committee evaluated a number of things, such as market information and NYSE performance factors not taken into account in the ICP performance **metrics**, in determining what the right additional bonus amount, if any, should be awarded, including whether the bonus should be above the \$700,000 target.

The Committee decided to award Grasso total compensation of \$11,999,999. All on the Committee agreed that the Committee voted on the total compensation number of \$12 million and then Ashen "backed into" the subcomponents of ICP and CAP, taking into account Grasso's **fixed** salary of \$1.4 million.

When asked why the compensation to Grasso decreased by nearly \$20 million from the prior year, while the benchmark for Grasso's compensation level had decreased by only \$5 million, several directors who were on the Committee in prior years explained that compensation in general was down generally "on the Street." Grasso's performance, they stated, was the same or better, so that was not a factor in the reduction. They also said that they did not recall Grasso's proposed new employment **contract**, and his high level of accumulated **SERP** benefits, which recently had become **known** to the Committee, as being factors in the reduction of Grasso's compensation.

Some new Committee members said that their view was that a large cut from Grasso's previous year's compensation was essentially a step in the right direction as compared to Grasso's compensation for 2000 and 2001. One new Committee member indicated that he was surprised to **learn** of the high level of Grasso's previous compensation awards and in approving Grasso's 2002 compensation, took comfort in the fact that Grasso's compensation was down 50% over prior years. Another new Committee member said that, if he could have cut Grasso's compensation down further, he would have, but he felt that taking it down "in steps" was appropriate, and that perhaps there would be a further reduction the following year.

The breakdown on Grasso's compensation for 2002 was as follows:

Year	Salary	ICP	LTIP	CAP	Special Payments	Total
2002	\$1,400,000	\$7,066,666	---	\$3,533,333	---	\$11,999,999

c. Board Meetings: Recommendation by Compensation Committee to Board and Board Vote

Following the February Compensation Committee meeting each year, a Board meeting was held at which one of the main subject matters **was** compensation for the NYSE's employees, including Grasso's compensation.⁸³

Typically, at the Board meeting, Ashen would report to the Board regarding the ICP performance evaluation for the previous year and would provide the percentage above target that had been achieved on the empirical performance factors. Either Ashen or Grasso would then review for the Board a number of the NYSE's significant accomplishments throughout the preceding year. Grasso would then address the Board with respect to his evaluation of the NYSE's performance – the Chairman's Award – and would present his recommendation. Following Grasso, the Committee Chairman would address the Board regarding the Committee's recommendation as to the proposed ICP award for managerial and

⁸³ Note that, because of time constraints and logistical issues in the investigation, we did not interview any Board members who were not either on the Compensation Committee at some point or on the Board on August 7, 2003, when Grasso's 2003 contract was discussed by the Board. Thus, the information we received regarding Board meetings prior to 2003 derives from Committee members and Board members whose service stretched back before 2003, as well as from Grasso, Ashen, and various documents.

professional employees. Usually both Grasso and the Committee Chairman would then present a total compensation recommendation for the President or Co-Presidents.

After Grasso excused himself from the meeting, the Committee Chairman would then report the recommendation of the Committee with respect to the yearly ICP award for Grasso. The presentation by the Chairman lasted only a matter of minutes and was not **very** detailed. Some Board members remarked that it was fairly perfunctory.

Some directors recalled that at times the Committee Chairman made reference to consultants being involved in the Committee's work and behind the Committee's recommendation. Other directors stated that Committee Chairmen also mentioned, albeit generally, that Grasso was being paid at a level commensurate with what other CEOs were making.

Prepared remarks for Committee **Chairman** Langone's presentation to the Board in February 2000, for Grasso's 1999 compensation, state in part: "This award is based on Dick's performance and is in line with the compensation of his peers as determined by Committee with **advice** from Hewitt, the Committee's compensation **consultant**."⁸⁴

Some other directors had no clear recollection of references to consultants or benchmarking being made by the Committee Chairman in presenting the Committee's **recommendation** regarding Grasso's compensation. All agreed, however, that there was no mention of the comparator group employed by the NYSE or any specific information about the **benchmarking** used by the Committee or the market or peer group information that had been provided by Hewitt.

Directors generally agreed that rarely if ever were any questions raised about the Committee Chairman's compensation presentation,' and that **no directors** raised questions or issues of any kind, or made any comments at the meeting, regarding Grasso's level of compensation, even in the years when Grasso was awarded approximately \$26.8 million (in February 2001 for 2000) and about \$30.6 million (in February 2002 for 2001).

A number of directors in years **after** 1999, when asked during interviews about the total compensation that Grasso was awarded each year, stated that they believed that they may not have been provided the full information about Grasso's compensation. They stated that they may have been provided only the bonus and salary information, for example, but not the CAP, which reached \$6.8 million for 2000 and \$8.1 million for 2001. **Thus, they stated they may not have been aware of the full amount of compensation being awarded to Grasso at the time they voted to approve the Committee's recommendation as to Grasso.** Langone and other directors, however, stated that they recalled that the full amount of Grasso's compensation was disclosed to the Board.

Unfortunately, for a number of years, we were unable to locate records definitively establishing the amount of Grasso's compensation that was disclosed to the Board each year. However, Langone's speaking points for his presentation to the Board in February 2002, for Grasso's 2001 compensation, suggest that in that year he reported to the Board incomplete information regarding the compensation for Grasso. The speaking points state:

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See NYSE 042156-57.

This year, the Committee recommends that Dick receive, in addition to his salary: \$16.1 million in variable compensation (up \$2.5 million from last year); a Special Payment of \$5 million that he will receive when he leaves the Exchange that will also be placed in his SESP account – the Exchange's nonqualified Savings Plan. Like the Special Payment we made last year, the \$5 million will not be eligible for the Capital Accumulation Plan, nor will it be a part of Dick's retirement calculation. As a result, the Committee recommends that Dick's compensation be raised \$2.5 million, including a deferred special payment of \$5 million.

These speaking points make no mention of Grasso's \$8,050,000 CAP award that year, and do not tally up the salary, ICP award, CAP award, and special payment to provide the Board with the full disclosure that the total compensation that year is \$30.55 million. In addition, Grasso's compensation actually went up that year \$3.75 million, not \$2.5 million, due to an increase in Grasso's CAP award of about \$1.25 million from the prior year. Thus, these speaking points suggest that the Board may have been **left** with an incomplete picture that year regarding Grasso's total compensation.

Each year, the Board approved the Committee's recommendation concerning Grasso's compensation. While Board members all had slightly different recollections regarding what was presented during the Committee **Chairman's** presentation of Grasso's recommended compensation award, all agreed that nothing was mentioned about SERF' benefits of any employees, including Grasso, and that they were not told of Grasso's or any other employee's accumulated SERF' benefits. Several directors indicated that they would have wanted to know about the SERP accumulation in connection with their compensation decisions for Grasso, that such information was material and should have been provided to them, and that it would have been important to their decision making concerning Grasso's yearly compensation.

C. The Process By Which Grasso's Pension Benefits Accumulated During His Tenure as Chairman and CEO of the NYSE

As outlined infra, Grasso received contractual **SERP-like** benefits that were built into his 1990, 1995 and 1999 employment contracts. His contractual SERF' benefits largely mirrored the SERF' benefits provided to the NYSE employees who participated in the SERP.

Under Grasso's contracts, his **SERP** benefits were determined by two main factors: (1) his final average annual pay (salary plus ICP award only), which consists of the highest consecutive three years of his pay during the last ten years of his service at the NYSE; and (2) his total years of service at the NYSE, which determines the percentage of his **final** average pay that he is eligible to receive as a SERP annuity benefit (e.g., for 35 years of **service**, the percentage is 65% of the final average **pay**).⁸⁵ Thus: setting aside other minor adjustments, if Grasso's highest three consecutive years of pay (salary plus ICP award) in the last ten years averaged \$10 million, and he had worked for 35 years, his lifetime SERF' annuity would be \$6.5 million (65% of \$10 million). Under Grasso's contract, he also was eligible to take a lump-sum SERP benefit upon retirement, which would be equal to the present value of his lifetime SERP annuity, based on the expected duration of that annuity (**per** a mortality table) and an interest rate (determined by a contractual formula).

As is evident from the SEW formula, the "drivers" of Grasso's SEW benefits were his salary and ICP awards. The higher the average of his best three consecutive years of salary and ICP awards, the higher

⁸⁵ See NYSE 000096,000117-19, 000877-902.

calculation and SERP benefits accumulation. Based on the analysis of Mercer¹⁰² and Hewitt¹⁰³ the Committee determined that, by making only 85% of Grasso's ICP award SEW-eligible, the increased ICP awards as a result of the elimination of LTIP would result in increased ICP awards being "cost neutral" to the NYSE.¹⁰⁴

By letter agreement dated August 30, 2001, and signed by both Langone and Grasso, Grasso's 1999 employment contract was amended to reflect that, as of May 1, 2001, 85% of Grasso's ICP would be included in calculating his SERP benefit.¹⁰⁵ The NYSE and the Committee agreed that "it is intended that [Grasso's] potential future awards under the NYSE's annual incentive compensation program ('the Annual ICP') will be increased to make up for the elimination of your incentive opportunities under the LTIP."

3. 2003 Contract

In the Summer of 2002, Grasso and the Compensation Committee (through its Chairman, Kenneth Langone) began discussing the possibility of extending, or renegotiating, Grasso's 1999 employment contract, which was due to expire in May 2005. The renegotiation process continued for about a year and culminated on August 7, 2003 with the Board approving a contract extension and cash payout to Grasso of about \$139.5 million in deferred compensation and benefits. Grasso signed a new employment contract on August 27, 2003. Grasso then resigned on September 17, 2003.

a. Summer 2002: Initial Discussions Regarding New Contract

Grasso and various Committee members agreed that the idea of renegotiating Grasso's 1999 employment contract first emerged in about July or August of 2002. According to Grasso, the subject of extending his contract first came up while he was in the course of building the NYSE's 2003 budget. He stated that, at that time, he and Langone were discussing succession planning, and the idea of renegotiating his contract was raised more by him than by Langone. Grasso explained that, earlier in 2002, the Committee had asked him if he intended to leave the NYSE, and he thought extending his contract and thereby removing the lingering question of whether he intended to stay at the NYSE would be a positive step for the NYSE.

Langone, on the other hand, said he, not Grasso, first initiated the conversation with Grasso regarding a contract extension. Langone said that Grasso did not ask for the renegotiation, and never raised the issue. Langone explained that he approached Grasso about extending his contract because the Committee had expressed a desire to ensure Grasso would remain at the NYSE beyond the expiration of his current contract, and the Committee had asked him, as Committee Chairman, to broach the subject of a contract extension with Grasso. Langone stated that, at that time, the Committee was concerned about whether Grasso might leave the NYSE for another position, and what the NYSE would do in terms of succession if that occurred. Langone stated that he had learned from sources in Washington, D.C. that Grasso was being considered as a possible replacement for Paul O'Neill as Secretary of the Treasury. Langone said he had mentioned this information to the Committee, and the Committee then requested that he speak with Grasso to determine what Grasso's intentions were with regard to continuing as Chairman and CEO.

¹⁰² See NYSE 029762-65.

¹⁰³ See NYSE 052732-54.

¹⁰⁴ See NYSE 000066-67.

¹⁰⁵ See NYSE 030131-34.

Langone said he approached Grasso and inquired whether Grasso had any intention of leaving the NYSE. According to Langone, Grasso strongly assured him he had no intention of leaving the NYSE for another position. Grasso stated that he had told not just Langone, but the Committee and Board as well on numerous prior occasions, that he had no intention of leaving the NYSE. Grasso emphasized that when he said that, it was not just a perfunctory statement, it was true.

Langone said that, after speaking with Grasso, he reported back to the Committee that Grasso had no intention of leaving the NYSE and said that if the Committee's desire to renegotiate Grasso's contract was based on a perceived concern about Grasso leaving the NYSE for another position, they did not have to be concerned about that. Langone said that, notwithstanding Grasso's assurances that he had no intention of leaving the NYSE, the Committee expressed a strong desire to "lock up" Grasso for additional years and asked him to go back to Grasso and relay the Committee's desire to extend his contract.

Some other Committee members recalled that the subject of a contract extension for Grasso arose due to a concern by some on the Committee about Grasso leaving the NYSE. Another Committee member believed that the subject came up simply because Grasso had asked the Committee to consider reworking his contract so that he could take out the deferred compensation and benefits that he had accumulated. Most of the other Committee members did not have a strong recollection of the genesis of the idea to renegotiate Grasso's 1999 contract.

Grasso, Langone and other Committee members agreed that, when Grasso and Langone began discussing a possible contract extension, Grasso was receptive to extending his term, but made clear that, if his term was to be extended, he wanted a draw down or payout of his deferred compensation and accumulated pension benefits. Grasso provided three reasons why he wanted a payout: (1) for estate planning purposes; (2) because he wanted to begin a more formalized process of charitable giving (he explained that he wanted to create a personal foundation and start giving in a more structured manner); and (3) because he had some "trepidation" with regard to the large size of his accumulated SERP benefits and he was concerned that a future Board would not honor (*i.e.*, pay out) those benefits.

Grasso explained that he had no doubt that the current Board would honor his right to the accumulated SERP benefits, but noted that most or all of the Board members who had awarded him these benefits would be gone by the time he retired or otherwise received the payout. He said that he wanted to take the issue off the table by taking out the money at that time, in connection with the extension of his contract. Grasso stated that he had not given specific thought to the manner in which a future Board might seek to deny him the SERP benefits, *e.g.*, a legal challenge, but that he simply thought it was in his best interests and the interests of the NYSE to get the benefits off the books.

b. September 23, 2002 Compensation Committee Meeting

On September 23, 2002, the Compensation Committee conducted its first meeting at which the potential extension of Grasso's 1999 employment agreement was discussed.¹⁰⁶ The meeting was conducted by telephone. In attendance were Langone (Chair), and directors Cayne, Fink, Karmazin, Komansky, Levin, Murphy and Schrempp. Others in attendance included Ashen, Chief Financial Officer Keith R. Helsby and Mischell of Mercer.

¹⁰⁶

See NYSE 000015.

The **Committee** had before it at the meeting a proposal to amend Grasso's employment **agreement**.¹⁰⁷ The proposal had been prepared by Ashen prior to the meeting, and included the following **terms**:

- extending the term of the agreement by 19 months, from May 31, 2005 to December 31, 2006;
- capping Grasso's compensation for SERP calculation purposes (resulting in annual SERP expense for Grasso of only \$7.1 million per year instead of **\$24.5 million per year**);
- **transferring**, on a yearly basis beginning **February 1, 2003**, a **total** of \$51.5 million in accrued benefits from SERP to SESP (effectively accelerating this payment from January .1, 2007 to earlier dates); and
- accelerating from **February 1, 2006** to February 1, 2003, the vesting of Grasso's previously awarded Retention Payment of \$5 million.

The proposal provided for the transfer of \$51.5 million of Grasso's accumulated **SERP** benefits from his SERP account to his SESP account, rather than a direct payout of those benefits, and did not provide for the payout of any deferred compensation to **Grasso**.¹⁰⁸ The stated "purpose of the proposal was to reduce the impact of the amortization of the NYSE's unfunded liability" and to avoid a big balloon payment at the end of Grasso's employment. At that time, calculations showed that the balloon payment owed at the **termination** of Grasso's employment in May 2005 would have been over \$110 **million**.¹⁰⁹

Ashen and Langone described the proposal to the Committee. One director, who was new to the Committee at that time, stated that, upon seeing the size of Grasso's SERP benefit for the **first** time in connection with the contract proposal, he thought it was a typo. (He recalled that benefit being presented as about \$120 million.) He explained that he brought it to Langone's attention and was informed by Langone that it was not a typo and that Grasso deserved the money. The director told Langone that the Committee should get a compensation consultant to examine the proposal because the level of benefits was "out of whack." Other directors raised similar concerns.

After extensive discussion, the Committee decided to hire a consultant who had no dealings with the NYSE to review the contract proposal. Specifically, according to Ashen, the Committee wanted a third party to review the proposal so that the Committee would reach a "comfort level" that it was not "doing something silly." He said the Committee was concerned about insulating itself from potential criticism regarding this extension, and wanted professional consultants to examine the proposal and bless it.

¹⁰⁷ See NYSE 000016-17

¹⁰⁸ Grasso **was** adamant that it was never his desire, in the context of the renegotiation of his 1999 **contract**, that the **SERP** draw down be in the **form** of a **SERP-to-SESP** transfer. Rather, he stated, "if it was happening, it was a payout." Likewise, Langone had no recollection of Grasso requesting a transfer between accounts rather than a payout. Ashen, however, said that Grasso originally said he wanted to transfer money from his **SERP** to his SESP account, **as** he had done in 1999, and thus he drafted the proposal accordingly. Documents clearly reflect the fact that the proposal, as initially constructed, called for a **SERP-to-SESP** transfer and was later amended to provide for a **cash** payout.

¹⁰⁹ The proposal would have reduced the **end-of-contract** balloon payment to Grasso to \$28.6 million in December 2006 and would have reduced, overall, the lump-sum payout to Grasso from \$110 million to \$80 million.

c. September 24, 2002 to October 2, 2002

On Langone's recommendation, the Committee retained Robert Stucker and Thomas Desmond of Vedder, Price, **Kaufman** and **Kammholz** ("Vedder, Price") to conduct an analysis of the proposal concerning Grasso's contract **renegotiation**.¹¹⁰ Stucker **confirmed** that he received a call from Langone and was informed that the Committee had a proposal before it to amend the contract of the NYSE's CEO that would result primarily in an extension of the contract term and a distribution of retirement benefits to the CEO. Langone explained to Stucker that someone on the Compensation Committee had said that the Committee should get a fresh set of eyes to look at the proposal and see if it was appropriate. According to Stucker, Langone asked Vedder, Price to take a look at the proposal, and come to the Committee meeting and tell the Committee whether it was a "normal" or "appropriate" thing to do. Stucker said he was told by Langone that the Committee was meeting in approximately a week to discuss the issue, and thus he had "a very short leash."

It is important to note that our factual investigation revealed a dispute as to the scope of Vedder, Price's engagement regarding this matter for the Committee. Ashen insisted that Vedder, Price was hired to essentially give either an opinion or **recommendation** as to whether Grasso's past compensation was appropriate and as to whether the terms of the proposed new contract with Grasso were reasonable and appropriate. Stucker stated, on the other hand, that while Vedder, Price was asked to analyze and provide comments on the draft proposal to extend Grasso's contract, Vedder, Price was never asked to provide a specific opinion or recommendation on the proposal or on Grasso's past compensation levels. Stucker stated that they were told by Langone that the goal of the proposal was to retain Grasso and, with that in mind, Vedder, Price was asked to review the proposal and assess whether it achieved that stated goal.

Langone's recollection was consistent with that of Stucker. Langone stated that he did not recall asking Vedder, Price for an ultimate opinion on the proposal and was adamant that Vedder, Price was not asked to review Grasso's past compensation, since the Committee did not have **reservations** about what Grasso had been paid up through that time. According to Langone, Stucker was told that the Committee's goal was to retain Grasso and was presented with the proposed deal and asked *to* "make sure it was right."

Stucker stated that, during his early discussions with Langone and Ashen, the contract proposal was presented by Langone and Ashen along the lines of the following: "We have a proposal that's a 'no brainer'" and "it's essentially a done deal"; "the Committee is on board with it (at least most of them)" and "Hewitt and Mercer have signed off on it."

After being retained, Vedder, Price worked on its analysis for about a week and prepared a report for delivery to the Committee at the Committee's next meeting on October 3, 2002. The report listed various "considerations" that Vedder, Price thought the Committee should consider with regard to the contract proposal and contained some data analyzing Grasso's past compensation levels, but did not provide any specific recommendation or opinion as to what the Committee should or should not do. In preparing their report, Vedder, Price spoke with and received information and materials from Ashen, as well as from the Committee's compensation consultant, Jeff Hyman of Hewitt, and the Committee's benefits consultant, William Mischell of Mercer.

¹¹⁰

Langone was familiar with Stucker by virtue of Langone's service on the Board of Directors of **Home Depot**. Stucker had negotiated the contract of current Home Depot Chairman and CEO Robert **Nardelli** while Langone was on the Home Depot board, and had made a favorable impression upon Langone.

d. October 3, 2002 Compensation Committee Meeting

On October 3, 2002, the Committee met again and discussed for the second time the possibility of extending Grasso's employment contract.¹¹¹ In attendance were Langone (Chair) and directors **Cayne**, **Fink**, **Karmazin**, **Komansky**, **Levin** and **Murphy**. Others in attendance included **Ashen**, **Desmond** and **Stucker** of **Vedder, Price, Hyman** of **Hewitt** and **Mischell** of **Mercer**.

At the outset of the meeting, **Ashen** explained to the Committee that **Vedder, Price** was the third party that had been hired to conduct the analysis of the proposal to amend Grasso's contract and that **Vedder, Price** had completed its analysis after conferring with **Hewitt** and **Mercer**.

At the meeting, **Stucker** handed out to the Committee members present **Vedder, Price's** written report.¹¹² He then outlined **Vedder, Price's** analysis, walking through the report page by page. **Stucker** reviewed the section of **Vedder, Price's** report entitled "CEO Compensation Review" and explained to the Committee **Grasso's** past compensation and benefits, pointing out, among other things, that **Grasso's** 2001 compensation (listed as \$26.3 million) was substantially higher than the compensation of CEOs in the NYSE comparator group (\$13.5 million) and that **Grasso's** estimated pension benefits at age 60 (\$122-152 million) were substantially higher than the estimated pension benefits at age 60 of CEOs in the NYSE comparator group (\$21-29 million). He explained that while **Vedder, Price** was not asked to specifically outline this information for the Committee or conduct an analysis of it, they thought it was important to provide this information to the Committee so that the Committee could understand the background of how the pension and deferred compensation that was proposed to be paid out under the new contract had built up over time. **Stucker** stated he was not asked for an opinion as to magnitude of **Grasso's** compensation or benefits.

Stucker stated that he and **Desmond** made clear they were simply presenting "thoughts and considerations" on the proposal and, in particular, they made the following observations for the Committee:

- It was unusual to allow an executive to collect retirement benefits prior to retirement, as the proposal called for.
- There may be better ways for the NYSE to save money than by allowing **Grasso** to take his retirement money out, such as capping the amount of compensation that was SERP-eligible.
- The proposal had no retention value,

Stucker stated that **Vedder Price's** report generated a lot of discussion among the Committee members at this time. One Committee member stated that he specifically recalled asking: "If [Grasso] quit or left for any reason, was all of this money his?" He said he was told "yes." He stated that he "was told" that all of the money **Grasso** wished to take was vested and that if **Grasso** left the NYSE in 2002, for any reason whether he was fired or left voluntarily it was all his. According to this director, **Ashen** was the principal source of this information. Another director recalled being concerned about paying this money out in the midst of the **Enron**, **Tyco**, and **WorldCom** scandals (among others). The director specifically recalled

¹¹¹ See NYSE 000022-23.

¹¹² See NYSE 000137-54.

asking, with regard to the large benefit, "Who knows about this? Do the members know?" He was told "No."

According to the meeting minutes, Stucker "recommended that the Committee recommend to the Board of Directors that the proposed modifications to Mr. Grasso's employment agreement be made with the exception of accelerating vesting and payment of the retention award that fully vests February 2006."¹¹³ Stucker informed us that he made no such recommendation and pointed out that Vedder, Price's report gave "considerations" not recommendations. He stated plainly that the statement in the minutes to the contrary was wrong. Though Ashen, who wrote the minutes, maintained that "the Committee approved the minutes, so that must be what happened," he conceded that **Stucker** had concluded that whether or not to enter into the contract was "up to the Committee." He also acknowledged that Stucker was "not enthusiastically endorsing [the contract], but did not say it was crazy." Further, Ashen noted that Vedder, Price was not as "crisp" or "clear" as he and the Committee would have liked them to be in terms of **providing** a thumbs up or thumbs down.

Members of the Committee at this time have differing views as to the role that Vedder, Price played at the Committee meeting. For example, one director stated that he was not looking to Vedder, Price to recommend whether the NYSE should or should not go **forward** with the proposal. His understanding was that Vedder, Price was asked to assess whether it was in fact allowable and legal under the structure of the NYSE plans for **Grasso** to receive his retirement and **deferred** compensation as a lump sum before in fact retiring. In his view, Vedder, Price determined that this was allowable and that is what he looked to Vedder, Price for in **terms** of a "recommendation." Another Committee member stated that he did not know one way or the other whether Vedder, Price made a recommendation. Yet another Committee member stated that it was his recollection that Vedder, Price did, in fact, recommend that the proposed deal be approved. To further underscore the range of views as to what Vedder, Price's role was, **Jeff Hyman** observed in a memo to file dated October 4, 2002 that "[t]he Committee retained Stucker for the purpose of providing an independent view of Dick Grasso's **SERP** benefit," after "one new Committee member" indicated Grasso's **SERP** benefit "seemed extraordinary" and "requested the review to comply with their fiduciary **requirements**."¹¹⁴

After sitting in Executive Session and considering the proposal outside the presence of Ashen and the consultants, the Committee agreed upon various modifications to the contract proposal. At the conclusion of the meeting, the Committee directed Stucker and Ashen to prepare "a short description of the modifications for the Committee's review, with the added direction that the changes be shown not to increase costs to the **NYSE**."¹¹⁵

In his memo to file dated October 4, 2002, **Jeff Hyman** wrote, in part, regarding the October 3 Committee meeting:

[t]he Committee asked that the range of possible responses to Grasso's proposal be documented, and a tentative decision articulated so that the Committee can review and vote at its December meeting. It then will present its recommendation (albeit in some oblique fashion) to the **full** board for their approval. The Committee does not want to

¹¹³ See NYSE 000023.

¹¹⁴ See NYSE 059264-65

¹¹⁵ See NYSE 000023.

disclose to the full Board the dollar value of the lump sum **SERP** benefit, so the Committee Chairman is likely to use general terms in describing the Committee's deliberations in an effort to minimize conversation on the matter by the full **Board**.¹¹⁶

No Committee members, however, told us that the Committee had any intention to provide vague or incomplete information to the Board on the proposal.

e. October 4,2002 to October 17,2002

On October 7, Vedder, Price sent a letter addressed to Langone, and copying the entire Committee, as well as Ashen, Hyman and Mischell, which summarized Vedder, Price's understanding of the Committee's conclusions regarding the proposed modifications to Grasso's contract." Specifically, the letter indicated that the Committee had "tentatively approved" the following terms:

- "Extend the initial term of Mr. Grasso's Employment Agreement to December 31, 2006 from May 31,2005;
- Modify Mr. Grasso's pension (**SERP**) benefit to cap his **final** average compensation at its current level, thereby capping future accruals as well.
- In early 2003, transfer \$51.5 million to ~~the~~ Executive's SESP account, which amount shall be a credit against Executive's eventual lump sum pension;
- No change to the vesting of the **February** 1, 2001, \$5 million special retention payment award, thereby maintaining the February 1,2006 **cliff-vesting** date; and
- With regard to the award of incentive compensation for 2002 (to be determined in February 2003) and for subsequent years, the Committee will consider crediting a more significant portion of such awards to CAP or other similar arrangements that cliff vests on December **31, 2006**."¹¹⁸

Ashen asked Vedder, Price to **reformat** the conclusions set forth in their October 7 letter into a term sheet for use in connection with future Committee and Board deliberation on the proposed contract. By letter dated October 17, 2002, Vedder, Price transmitted such a term sheet to Langone, and made note that it was Vedder Price's understanding from Ashen that the contract matter would "not be taken up for **final** action until the February **meeting**."¹¹⁹

¹¹⁶ See NYSE 052964-65.

¹¹⁷ See NYSE 049102-05.

¹¹⁸ See NYSE 049102-03.

¹¹⁹ See NYSE 0491 10-11

f. January/February 2003

(i) Late January to Early February

According to Ashen, in about January 2003, Grasso told him he had decided to take a cash payout of his accrued SERP benefit instead of transferring it to SESP, as had originally been planned. Ashen stated that **that** he and Grasso discussed whether Grasso should transfer the money or take it in cash. He said that Grasso **knew** that a cash payout would trigger a severe tax penalty, and that the "optics" of a cash payout would be bad. He explained that Grasso said part of his reasoning for taking the payout now was that the SERP payout would be smaller in 2003 than it would be if he took it at the end of 2007. Moreover, Ashen stated that Grasso believed there would be a strong reaction to the magnitude of his retirement package, and that he did not want to retire, take a huge sum of money and leave the fallout from the payout for his successor to deal with. Grasso did not have any recollection of this conversation and, as stated *supra*, said that the proposal always involved a cash payout of SERP, as opposed to a SEW to SESP transfer.

Ashen said that, based on these discussions with Grasso, he modified the proposed new contract **terms**. Among the changes, the contract was to be extended to February 1, 2007, rather than December 31, 2006, as originally proposed, and Grasso was to receive a cash payout of \$51.5 million in SEW benefits, rather than a **transfer** of those benefits to his SESP account. Completely new was a proposal to pay Grasso \$79,055,148 of earned and deferred compensation. It is unclear precisely how, when or why this term became part of the proposal.

On February 5, Ashen provided Stucker with a page from the Committee briefing book for the February 6 meeting that addressed the "Changes to Richard A. Grasso's Employment Agreement." Ashen also explained to Stucker that the Committee members had been briefed by him on the changes, except for the proposed payout of more than \$79 million in deferred compensation.

(ii) February 6, 2003 Committee Meeting

On February 6, 2003, the Committee met and, in addition to making 2002 compensation determinations for Grasso and others, once again considered the proposal for amending Grasso's contract.¹²⁰ In attendance were Langone (Chair) and directors Cayne, Fink, **Karmazin**, **Komansky**, **Levin**, **Murphy** and **Paulson**. Others in attendance included Ashen, Hyman, Stucker, and **Desmond**.¹²¹

At the meeting, Ashen noted several changes to the proposal had been made since the Committee had last met to discuss the matter in October 2002, and he reviewed those changes with the Committee. Specifically, the following "Changes to Richard A. Grasso's Employment Agreement" were addressed by the Committee at this meeting:¹²²

¹²⁰ See NYSE 000026-28

¹²¹ Grasso was also in attendance for the discussion regarding the yearly compensation for NYSE staff but left prior to any discussion regarding the proposed contract.

¹²² See NYSE 013147.

- Extension of the employment term from May 31, 2005 to **February 1, 2007**.
- Modification of the SERP pension benefit calculation so that compensation would be capped at its then present level, with **service** credit continuing to accrue.
- Payment, as soon as practical, of the earned and accrued vested portion of Grasso's pension benefit – 51.5 million; and payment each February of the amount accrued in the prior year.
- Payment, as soon as practical, of the earned and accrued vested **portion** of deferred compensation – \$79,055,148 – including deferred salary, deferred incentive compensation, vested special payment, SESP contributions and match, vested CAP awards, CAP awards to vest February 2003, and prior pension transfer. Payment each February of newly vested **compensation** including CAP, SESP, and special payment including Capital Accumulation Plan Awards to vest February 2003.
- Retention of 1983 Mortality Table for Grasso's **SERP** calculation.

Notably, these terms were set **forth** in the Committee briefing book that was distributed to all Committee members.

According to Ashen, he had previously briefed Committee members on these changes, with the exception of the proposed payment of approximately \$79 million in deferred compensation. He said only two Committee members **knew** of that proposed payment before the meeting because this proposal was only developed shortly before the meeting and he did not have time to brief all Committee members about the change.¹²³

After Ashen reviewed the modified **terms** of the proposal, he once again introduced **Stucker** and Desmond to the Committee, and they distributed to Committee members a report they had prepared **regarding** the revised contract proposal. Stucker addressed the Committee and repeated much of the same overview and analysis that he had provided in October, but also spoke to the changes detailed by Ashen. Specifically, with regard to the proposed early payout of Grasso's SEW pension benefits and deferred compensation, Vedder, Price's analysis stated:"

- Regarding \$51.5 million advance pension payment: "It is rare for executive **SERPs** to provide such pre retirement cash payouts. Payment represents an opportunity cost to the NYSE. Due diligence issues associated with CEO request to 'cash out'."
- Regarding \$79 million advance payment of deferred and incentive compensation amounts: "Acceleration is rare and inconsistent with **tax-deferral** and retention orientation of these programs. Cash flow impact and opportunity cost to the Exchange. Mechanism to recover payment of any amounts subject to forfeiture for pre-retirement voluntary resignation or for 'cause' termination. Due diligence issues associated with CEO request to 'cash out'."

¹²³ See NYSE 030759-72

¹²⁴ See NYSE 049120-32

Stucker stated that Vedder, Price's general commentary on the proposal, following these changes, was that it was even more unusual and executive **friendly** than the original proposal. Stucker was pressed by at least one director at this meeting to provide a recommendation as to whether or not to approve the proposal. Stucker stated that he responded by telling the Committee that "[w]e're not here to recommend. We were retained to take a look at the proposal. We'll give you our thoughts regarding the proposal in view of the goal of retention, but it's a business judgment decision for the Committee, it is not for us to recommend." Stucker stated that neither he nor Desmond ever gave an opinion or recommendation regarding the **proposal**, and that he could not recall anyone on the Committee objecting to his refusal to do so. Some of the Committee members, though, indicated that they were **frustrated** with Vedder, Price's refusal to provide a clear recommendation one way or the other.

Following Vedder, Price's presentation, the Committee discussed in detail the pros and cons of the proposal, the financial impact of the proposal on the NYSE, and the implications of **making** the proposed changes for the NYSE and **Grasso**. Stucker recalled there being "**gridlock**" on the Committee because some members were very agitated about the changes having been brought forth at the last minute. Specifically, Stucker stated that the proposal was held up because people were upset both about the newness of the revised proposal and the absence of any financial analysis to backup the assertion that had been made that the revised proposal presented potential **tax-related** financial benefits to the NYSE.

At the conclusion of the meeting, the Committee decided that to engage the NYSE's CFO and an outside financial expert who was knowledgeable about the NYSE's plans to develop an **analysis** of the financial implications to the NYSE and Grasso of the new proposed contract **terms**.¹²⁵ The Committee also decided that Ashen would meet with each Committee member individually and arrange a telephonic Committee meeting in March to discuss the subsequent analysis of the contract proposal, so that the Committee could be prepared to recommend the proposal to the Board at the Board's next meeting in April.

Ashen stated that, despite the Committee's request for this **further** analysis, he was left with the definite impression at **this** meeting that the Committee approved of the proposal so long as it was cost **neutral**. Ashen hired Mercer, who, as discussed infra, serves as the NYSE's benefits and actuarial consultant, to conduct the financial analysis.

g. Late February/March 2003

(i) Mercer Analysis and Report

Pursuant to Ashen's request, Mercer conducted an analysis of the financial implications of entering into the new contract as compared to the financial implications of doing nothing, *i.e.*, leaving the 1999 contract in place and assuming that Grasso would work until June 1, 2005 under that contract. Mercer concluded that the proposed new contract would result in relatively minimal savings for the NYSE, and prepared a report detailing its analysis and that conclusion.

Mercer's 15-page March 2003 report, entitled "Financial Analysis of Proposed Changes to Employment Agreement" considered, among other things, the following proposed changes to Grasso's contract, and offered the **following** conclusions regarding the financial impact of those proposed **change**.¹²⁶

¹²⁵ See NYSE 000028.

¹²⁶ See NYSE 049199-214

- Extend employment contract to June 1, 2007.
- Pay **SERP** amount accrued in the amount of \$51,574,000
- Pay deferred compensation of \$80,683,000 which includes the vested portion of CAP.
- Each year the NYSE pays Grasso his SESP **deferral** and matching contribution (\$144,000 total) and that portion of CAP which becomes vested during the year.

Conclusions:

- **SERP:** NYSE saves, on a present value basis (net of taxes), \$286,000.
- Deferred Compensation: NYSE saves, on a present value basis (**net** of taxes), **\$4,061,000**.
- Future Contributions: deductible to the NYSE; NYSE saves \$199,000.
- Proposed changes save NYSE on a net after tax, present value basis, \$4,148,000.

Based on Mercer's analysis, Mischell concluded that, from a financial standpoint, the consequences of entering the proposed contract were not great.

In communications between Ashen and Mischell regarding Mercer's analysis, Mischell questioned whether Ashen's characterization of the CAP portion of the \$79 million in deferred compensation as "vested" was **accurate**.¹²⁷ As Mischell pointed out, under Grasso's 1999 **contract**, his CAP awards were forfeitable in their entirety should Grasso leave the NYSE prior to the end of the contract's term, June 1, 2005, and thus were not truly "vested" until the conclusion of the contract's **term**.

With this in mind, Mercer presented to Ashen (in draft reports) three different versions of its analysis: Version 1 included paying out Grasso's entire CAP balance; Version 2 included paying only the CAP funds that had previously been funded in the Vanguard Rabbi **Trust**; and Version 3 included paying out none of Grasso's CAP balance. In a March 5, 2003 **e-mail**, Mischell presented Ashen with these three **options**.¹²⁸ Ashen explained that the Committee decided to go with Version 2, primarily because they wanted a retention device. (The Committee's desire for a retention device, he said, also explained why they did not use Version 1. Ashen said that the Committee did not select Version 3 because Grasso wanted to be paid his "vested CAP.") As per Ashen's **instruction**, the final version of Mercer's March report, presented to the Committee, referred to the CAP portion of the payout as "vested." **Ashen** told Mischell he would explain to Committee members that under Grasso's existing **contract** his CAP awards were forfeitable.

A Committee conference call was scheduled for March 28 to discuss the proposed contract and Mercer's analysis of proposed contract.

¹²⁷ See NYSE 048369.

¹²⁸ See NYSE 048369-432

(ii) Meetings with Compensation Committee Members

Subsequent to Mercer completing its analysis, in a ten-day span from March 10 to March 19, Ashen and Mischell met with all but two of the Committee members. In advance of each meeting, Ashen sent each Committee member a copy of Mercer's 15-page report, as well as a two-page summary of the report, which he had prepared.

At the meetings, Ashen offered the Committee members the option of going through either the two-page summary of the proposal or the entire 15-page Mercer analysis. Ashen and Mischell offered somewhat different accounts as to the general nature of these meetings. According to Ashen, he walked the Committee members through the analysis in "excruciating detail." In particular, he said all of the Committee members understood that the CAP portion of the proposed payout was forfeitable if Grasso did not complete the term of his contract (June 2005). Mischell, though, described the meetings as generally "perfunctory" and short, and indicated that during most, if not all, of the meetings, directors asked Ashen to simply go through the two-page summary.

One Committee member, who had not attended the September and October Committee meetings, stated that he learned of the proposal for the first time through this one-on-one meeting with Ashen and Mischell. This Committee member stated that, after becoming aware of the proposal, he had several telephone conversations with Grasso in March during which he tried to talk Grasso out of taking the payout. He said he told Grasso that it would be a big mistake for the NYSE and Grasso. He stated that, after speaking with Grasso, he was left with the impression that Grasso agreed not to pursue the payout at that time. Grasso did not recall any conversations with this director regarding the contract during the March time frame.

(iii) Vedder Price's Role in Preparing for the March 28, 2003 Committee Conference Call

In preparation for the Committee's March 28 conference call, various other communications between and among Ashen, Mischell and Vedder, Price took place. On March 12, Ashen forwarded to Vedder, Price Mercer's report and his two page summary of that report.¹²⁹ By letter dated March 14, and in a voicemail message, Desmond of Vedder, Price responded to Ashen with several questions regarding the proposed changes.¹³⁰ On March 14, Ashen sent an e-mail to Mischell (who had been copied on Vedder, Price's letter) noting, "[i]n his voicemail he [Desmond] hedged on whether Vedder, Price would recommend the proposal."¹³¹

A Vedder, Price report, entitled "Analysis of CEO Employment Agreement Modification Proposals" and dated March 28, 2003¹³² (though apparently prepared earlier than March 28), analyzed various provisions of the proposed contract and offered the following:

¹²⁹ See NYSE 049140-58

¹³⁰ See NYSE 049160-65.

¹³¹ See NYSE 047186-92.

¹³² See NYSE 049188-95.

“Vedder Price Analysis

- It is rare to pay out executive incentive deferred compensation and SEW benefits prior to **retirement/termination** of employment.
- There are costs and benefits in doing so, some of which have been identified in the analysis prepared by management and Mercer.
- If, based on information reasonably available to it, the Committee determines that:
 - the CEO has important and unique skills such that the Committee does not want to risk the CEO quitting now in order to access his deferred compensation and SEW cash,
 - the NYSE has the resources to fiscally accomplish the proposed case distributions and there are **tax** and other benefits to be garnered by doing so now, and
 - the going forward pay package (including **SERP** accruals and paydown of CAP account) are sufficient inducements to retain the CEO through the extended **term**,
 then the factual basis is present to adopt the proposals.
- Note, however, the documents and schedule of payments that would implement this proposal should be reviewed by the Committee and its advisors before the cash distributions are made.

In advance of the scheduled March 28 telephonic Committee meeting, final versions of both Mercer's report and Vedder, Price's analysis were forwarded to Committee members on March 26 so that they could be considered on the March 28 call.¹³³

(iv) Postponement of the March 28, 2003 Committee conference Call and Consideration By the Board of the Proposal at the April 4, 2003 Board Meeting

Shortly before the Committee's telephonic meeting to discuss the proposal was to take place on March 28, that meeting was cancelled. Consideration by the Board of the **contract** proposal at its scheduled April 4 meeting was also put off. According to **Grasso**, the contract proposal was not addressed at the April Board meeting as had been **planned** because he chose to defer it. He explained that at that time, the NYSE had "hit a firestonn" regarding the nomination of Sandy **Weill** to the NYSE Board. He stated that he thought the NYSE would take a lot of criticism when the new contract (and payout) was disclosed and "didn't think we should add this to the **Weill** firestonn." Grasso told Ashen that he did not want **the** contract issue to go forward at the April meeting, and to communicate his desire in that regard in that regard to the Committee. He recalled that he also told Langone, who agreed with his decision.

Several directors (and Ashen) speculated (or surmised) that the issue had been tabled because of the imminent reconfiguration of the Committee. Indeed, as of June 2003, the composition and structure of

¹³³

See NYSE 049196-21

the Committee was scheduled to and, in fact did undergo changes due to the NYSE's changes in its governance practices. According to Ashen, it made no sense to move forward with proposed changes to Grasso's compensation and employment agreement when a new Compensation Committee would have to consider and approve those changes.

Vedder, Price's involvement with the proposed contract ended with the cancellation of the March 28 conference call. They did not hear back from Ashen after the conference call was cancelled and next heard about the Grasso contract when it was publicly announced in August 2003.

h. June 2003

(i) June 5, 2003

In June, the initial report of the NYSE's Special Committee on Governance was issued. Among other things, that Report recommended that the charter of the Compensation Committee be revised to provide that only non industry directors may serve as members of the Committee. Pursuant to that reform, a new Compensation Committee was named, and H. Carl McCall replaced Langone (who was removed from the Committee altogether) as Committee Chairman.

On June 5, the old Committee held its last meeting. The substance of Grasso's proposed contract was not specifically discussed at that meeting. However, according to one Committee member, Langone gave an impassioned speech at the meeting regarding the importance of the Committee's work in making sure Grasso was paid adequately.¹³⁴

On June 5, following his appointment as Committee Chairman, McCall met with Langone and Ashen. Langone advised McCall that the Committee had negotiated and agreed to a new contract for Grasso, which included a term extension and a payout of approximately \$139.5 million in deferred compensation and benefits. McCall stated that Langone told him the Committee had signed off on the deal and was prepared to present it to the full Board. Langone stated that he told McCall, "you're not bound by what we've done to date," and that it was a new Committee, and "you can proceed as you see fit." According to McCall, Langone explained to him that the Committee had approved this arrangement in the fall of 2002 in order to keep Grasso, who was purportedly being wooed for a job in Washington, D.C., from leaving the NYSE.

McCall stated he was "shocked" by the large numbers involved and told Langone that "this is a lot of money." He was told by Langone and Ashen that the money was all due and owed to Grasso, had accumulated over Grasso's years at the NYSE and was all fully vested. McCall said he was not clear, at that time, as to when Grasso was entitled to collect the \$139.5 million. Further, he was told that the Committee thought this was the right time to go ahead with the contract. He stated that he had no understanding from this meeting that an additional approximately \$48 million in future payments would be due to Grasso under the terms of the proposed contract. In fact, he was clear that those future payments were not discussed at this meeting. Langone, however, recalled that he did not get into the details of the proposal with McCall, that McCall did not express shock when he met with Langone, and that McCall subsequently met separately with Ashen to get more details.

¹³⁴

See NYSE 021953

McCall stated that he walked away from the June 5 meeting thinking that the proposed contract was a big mistake and hoping that he could talk Grasso out of it. Langone and Ashen, however, stated that McCall didn't express any objection or concern during the meeting.

(ii) June 12, 2003

On June 12, Ashen and Mischell met with McCall to discuss the proposal in further detail, as they had with each of the Committee members in March. Mischell stated that Ashen, as he had during the March meetings, offered to go through the full 15-page Mercer report line-by-line, but that McCall declined. McCall recalled being provided with a copy of Mercer's full report, and the proposal, and being told that the proposed deal would save the NYSE \$2-3 million but did not have a specific recollection of a meeting with Ashen and Mischell. Mischell recalled that Ashen went through the two page summary with McCall. Mischell stated that the meeting lasted between 15 and 30 minutes and that the \$48 million in future payments under the contract were not discussed, although they were detailed in the Mercer report.

Ashen stated that in addition to the Mercer report and the two-page summary, he provided McCall with a summary of Grasso's deferred compensation and benefits and a compensation history for NYSE senior executives. He also stated that he explained to McCall that the "vested CAP" portion of the \$139.5 million could be forfeited under the 1999 contract if Grasso left the NYSE prior to retirement.

(iii) June 24, 2003

On June 24, Grasso and McCall had a one-on-one meeting during which the proposed contract extension and payout were discussed. (According to McCall, this meeting took place in Grasso's office and lasted 30-40 minutes.) In preparation for the meeting, Ashen gave Grasso a packet of material he had given to McCall, including a summary of his deferred compensation and benefits and analysis of proposed changes to his employment agreement.¹³⁵

McCall said he scheduled a meeting with Grasso to discuss the contract proposal and to verify that what he had been told by Ashen and Langone regarding the proposal was accurate. Specifically, McCall stated that he sought to confirm with Grasso that, as Langone had told him, Grasso wanted to move forward with the agreement at the August Board meeting. McCall stated that Grasso told him he did, in fact, want to go through with it. Specifically, McCall recalled that Grasso said he had been advised by his lawyer that it was important to take the money now and that he wanted to take the money at this point because he was concerned that a future Board might try to deprive him of the benefits he had accumulated. McCall stated that Grasso did not provide a reason for his concern that a future Board might deny him these benefits.

According to Grasso, McCall voiced concern over the payout, saying he thought it would produce controversy, a sentiment shared by Grasso. McCall said he specifically told Grasso that he was especially concerned with the payout given the environment that existed regarding executive compensation issues and the spotlight that had been placed on the NYSE, and Grasso himself, as a result of the Sandy Weill incident. McCall said he attempted, without success, to change Grasso's mind with regard to going forward with the contract. While Grasso recalled McCall expressing concern over the proposed deal, he stated that McCall did not attempt to dissuade him from taking the payout.

¹³⁵

See NYSE 032875-87.

At the end of the meeting, McCall inquired as to whether other Board members who had not been on the Compensation Committee were aware of the issue and Grasso told him they were not. McCall and Grasso agreed that McCall would contact all Board members who were not on the Compensation Committee to advise them of the proposed new contract.

According to McCall, immediately following his June 24 meeting with Grasso, he spoke with Ashen and asked him to get him a list of Board members whom Ashen believed had no knowledge of the proposed agreement. McCall asked for the list so that he could contact them and let them know about the contract proposal. Ashen volunteered to make the calls himself or to assist McCall in doing so, but McCall rejected his offer. Ashen agreed this conversation took place, but stated that it happened after the July 14 Committee meeting, discussed *infra*, at which the Committee voted to recommend the contract proposal to the Board at the August 7 Board meeting. Grasso had a similar recollection, and said that Ashen informed him after the July 14 meeting that McCall would be calling all non-Committee members to inform them about the proposal so that they did not first hear of it at the August 7 meeting.

i. July 2003

(i) Phone Calls By McCall to Board Members

During July 2003, McCall made calls to numerous (according to him, 18-20) Board members to inform them of the proposed Grasso contract. McCall advised the Board members he called that the proposed contract had two main provisions: (1) a contract extension of two years; and (2) a payout to Grasso of \$139.5 million in deferred compensation and benefits that were already accrued and to which Grasso was entitled. According to McCall, the majority of Board members he spoke to expressed "shock" and thought that this was a "big mistake." McCall said he asked these Board members to call Grasso to express their opposition to the deal. (Ashen said that these calls took place after the July 14 Committee meeting, and McCall agreed that at least some or many of the calls may indeed have taken place after July 14.)

(ii) July 7, 2003

Sometime prior to July 7, 2003, Grasso called McCall and suggested that he speak to Ashen and Martin Lipton of Wachtell, Lipton, Rosen & Katz, who represented the Board on a number of matters, regarding the disclosure of Grasso's proposed new contract. McCall met with Ashen and Lipton on July 7, 2003, in McCall's office. At that time, according to McCall, Lipton told McCall that, because the new governance guidelines passed in June 2003 required that compensation matters relating to the top five NYSE officers be reported in the Annual Report – which is issued in March of each year – there was no reason for the NYSE to disclose the new Grasso agreement in August, even if it was approved by the Board at that time. McCall responded that, if the Board endorsed the arrangement in August, it would need to be disclosed at that time. According to McCall, Lipton did not push back on the issue.

(iii) July 14, 2003

On July 14, 2003, the newly composed Compensation Committee met for the first time and discussed the proposed changes to Grasso's employment contract.¹³⁶ This was McCall's first meeting as Committee

¹³⁶

Immediately prior to that meeting, Ashen and Mischell met with the one new member of the Committee they had not previously met with to brief him on the proposal. Unlike most, if not all, of their prior meetings with Committee

Chair. In attendance were **McCall** (Chair) and directors Allison, Fink, **Karmazin**, **Levin** and Schrempp. Others in attendance included Ashen and **Mischell**.¹³⁷

At this meeting, Ashen reviewed for the Committee the discussions and analysis that had been going on for about a year concerning possible amendments to and extension of Grasso's employment contract. Ashen pointed out that the Committee had received input from **Hewitt**, Mercer and Vedder, Price, and that McCall had engaged in discussions with Martin **Lipton** of Wachtell **Lipton** on the subject of disclosure of the amendments to Grasso's contract.

The Committee had before it on this date Mercer's final report on the financial **consequences** to the NYSE and Grasso of the proposed changes. Mercer's July report, entitled "Financial Analysis of Proposed Changes to Employment Agreement" was essentially the same as its March 2003 report, except that the amounts of Grasso's various account balances had changed between March and **July**.¹³⁸ The proposed changes addressed by Mercer in its July report were as follows:

- Extend the Employment Agreement from June 1, 2005 to June 1, 2007.
- Amend the **SERP** provisions as follows:
 - Final average pay is frozen to reflect 1999, 2000, and 2001 ICP awards
 - The change in mortality table that went into effect as of January 1, 2003 is rolled back to the prior table
 - NYSE pays the executive the amount already accrued on the Balance Sheet (\$51,574 as of December 31, 2002) in September 2003
 - NYSE pays the executive the amount it accrues each year (*i.e.*, \$7,138 in early 2004, 2005, 2006 and 2007).
- The executive drops out of the Capital Accumulation Plan (CAP)
- NYSE pays to the executive the balance in his deferred compensation plan **account** - approximately **\$88,000[,000]** (including the vested portion of his CAP account) in September 2003. This amount has already been accrued on the Balance Sheet.
- Each year, the NYSE pays the executive the following amounts:
 - His SESP deferral and company match (**\$144[,000]** total)
 - The portion of his CAP award that becomes vested during the year.

members, this meeting lasted for an hour, Ashen and Mischell walked through the proposal in great detail, and the Committee member asked many substantive questions about the proposal.

¹³⁷ See NYSE 012954-55.

¹³⁸ See NYSE 000168-83.

In analyzing these proposed changes, Mercer noted, among other things, that under his 1999 contract, Grasso's projected SERP payout at June 1, 2005 was \$82,713,000 (or more if future ICP awards increased his average pay). Under the proposed **agreement**, the report set forth, "Executive receives **\$51,574[,000]** in September 2003" and "Executive receives **\$7,138[,000]** in early 2004, 2005, 2006, and 2007."

Mercer's report summarized the payments in five bullet points as follows:

- Pay Grasso the following amounts as of September 2003:

SERP	\$ 51,574,000
SERP Transfer	33,608,000
SESP	6,368,000
CAP	13,218,000
Deferred ICP/LTIP	29,618,000
Vested Special Benefits	<u>5,100,000</u>
Total	\$139,486,000

- The proposed changes save the NYSE \$3,601,000 on a net **after-tax**, present-value basis.
- The proposed changes cost Grasso \$1,433,000 on a net after-tax, present-value basis.
- In addition, the proposed changes to the Employment Agreement protect the NYSE against higher costs that could result if future ICP awards are higher or the **IRS** further improves the mortality table.
- Most importantly, the proposed contract changes extend the initial contract term from June 1, 2005 to June 1, 2007.

The Committee met in Executive Session to address the proposed contract. At the conclusion of the session, the Committee emerged and stated that it had voted to approve the proposed changes to Grasso's employment **agreement**, as set forth in Mercer's report, and to recommend those changes to the full Board. The Committee also directed Ashen to develop a template for how those changes would be disclosed in the NYSE's **Annual Report**, and to prepare a summary of Grasso's current agreement and to circulate that prior to the August Board meeting.

In addressing the proposed new agreement, **some of the holdover Committee members expressed strong feelings that the Committee already had made a commitment to Grasso to proceed with the new contract, and that the new contract had been agreed to by the Committee and Grasso, and thus should be honored.** (At least one holdover member stated that he understood the proposed changes would save the NYSE money, and was simply concerned with getting the deal done and disclosed as soon as possible for fear that the longer it dragged on, the more likely it was to be seen as having taken place "under my watch.") In response to questions raised by at least one Committee member as to the validity and binding nature of the prior compensation and benefits awards, it was explained (by Ashen **and/or** other Committee members) that Grasso was, in fact, entitled to the money he would be receiving under the new contract (*i.e.*, it was vested), that the Committee had approved the various benefits over time, and that the proposal had been vetted by consultants. **McCall stated that he remained concerned about the proposed new**



contract, but relied upon the representations of holdover Committee members in these regards and went along with them in voting to bring the proposal before the Board for approval.

According to Ashen, sometime after the July 14, 2003 Committee meeting, and prior to the August 7, 2003 Board meeting, Ashen and McCall had a conversation in which they agreed that **the Board** should be advised of the contract proposal in advance of August 7. Ashen suggested that he call all the Board members and tell them about it, but McCall told Ashen that he would do it. McCall then made calls to several Board members to let them **know** of the contract proposal. (As noted *supra*, McCall said this conversation with Ashen occurred on June 24, and that his subsequent calls to the Board occurred beginning earlier, in late June or early July.) Grasso said he was told by Ashen **after** the July 14 meeting that McCall would be calling all non-Committee directors to advise them of the issue.

Grasso said he knew this meeting was **occurring** and was told after the meeting by Ashen and perhaps McCall that the Committee was going forward with the proposal. Grasso said he had not spoken with any Board members outside of the Committee about the proposed contract up to this point. He said that, by this time, he had spoken with at least two Committee members about the fact there would be controversy surrounding the payout, but had not had any conversations with Committee members during which anyone suggested to him that he not take the payout.

(iv) July 29, 2003

By e-mail dated July 29, 2003, Mischell transmitted a letter to Ashen containing calculations of the SERP benefit that would be payable to Grasso at the end of the proposed contract (*i.e.*, "as of June 30, 2007"), under various interest rates. Mischell **provided** Ashen this information so Ashen would have it "in case it comes up at the August 7 meeting."¹³⁹ The projected lump sum payable ranged from \$0 using an interest rate of 4%, to \$11.9 million using an interest rate of 3%. Thus, Mischell wrote:

When we write the Agreement, we need to be **careful**. The Agreement should **not** say that he gets \$51,574[,000] in September 2003, four payments of \$7,138[,000] and nothing else. The Agreement should say that (1) the calculation is performed at 6130107 subject to current rules (for example, the maximum lump sum rate is 4%) and (2) all of the amounts described above are offset.

In other words, what we've told the Committee so far, and what we will tell them on August 7, was that he is giving up two things: He is locking in Average Pay (at the 1999-2001 level) and we are rolling back the mortality table. We never said that he is giving up the possibility of **getting** another payment at the end of his contract if interest rates drop.

j. Late July 2003 to August 6, 2003

Between the July 14 Committee meeting and the August 7 Board meeting at which the proposed contract was to be discussed, the issue of the proposed renegotiation and payout was the subject of much discussion and debate between and among directors, and between various directors and Grasso. Some Board members learned of the issue for the first time during this period, and others were told it was on the agenda for the August 7 meeting and later were told it was off the agenda. Indeed, Grasso himself finally

¹³⁹ See NYSE 047481-83.

decided that the contract renegotiation and payout should not be addressed at the August 7 Board meeting.

(i) Conversations Between and Among Directors

During this timeframe, McCall continued to phone non-Committee member directors whom he believed were unaware of the contract proposal to advise them of the proposal and the fact that it was going to be presented for Board consideration at the August 7 meeting. In his conversations with these directors, McCall generally advised the directors that the contract involved both an extension of Grasso's term and a payout of \$139.5 million in deferred compensation and benefits. McCall, who stated that, at that time, he had no knowledge or understanding of the approximately \$48 million in future payments provided for under the contract, did not advise the directors regarding those future payments. (As discussed, *supra*, McCall believed he began calling directors some time in late June to early July.) Directors with whom McCall spoke were generally surprised and concerned about the size of the payout.

Some of the directors who received calls from McCall recalled expressing concern regarding the size of the payout and specifically, the public reaction the payout would trigger. Reactions included: "it was going to be explosive"; "I thought we had a serious problem."; "This is a mistake"; and "We're dead Carl."

Some of the directors who received calls from McCall recalled questioning him as to whether Grasso was legally entitled to the money and, if so, when he was entitled to the money (*i.e.*, whether was vested), and whether consultants had looked at the proposal. These directors recalled McCall assuring them the money had been properly awarded and accrued, that Grasso was, in fact, entitled to it at retirement, and that consultants had vetted the proposal.

After speaking with McCall, several directors contacted other Board members to discuss the issue and share their concerns. There was an overwhelming sense among Board members that the payout at very least presented significant problems in terms of "optics," *i.e.*, how it would be received publicly.

(ii) Conversations Between Grasso and Various Directors

Several directors stated that, during this time frame, either at McCall's behest or on their own, they contacted Grasso to express their concern over the proposed contract, and to encourage Grasso to not take the payout. The primary concern raised by these directors was the negative publicity that would result from the payout and the impact it would have on the NYSE. One of these directors stated he told Grasso, "you won't survive this" if you take the payout, and explained that the NYSE could not give a public servant \$140 million in return for a mere contract extension.

According to Grasso, between July 14 and the August 7 Board meeting, he received calls from at least two Board members. He stated that he may also have received a call from a third director during this time frame, but was not sure. In any event, he did not recall a "flurry of calls." He explained that both directors called to express concerns about the publicity that would surround disclosure of the payout. While he stated that neither tried to talk him out of taking the payout, he "sensed from both they would've preferred I not take the draw down." Both of these directors stated they, in fact, told Grasso not to take the payout.

During his **conversation** with one of these directors, Grasso expressed his "Trepidation" regarding the payout. According to Grasso, the director had told him he was happy Grasso was staying, but concerned that the publicity surrounding the payout would be bad. He said that he told Grasso that he should defer **taking** his payout until retirement. In response, Grasso told the director he didn't want to do that because, while confident the current Board would honor his benefits, he was concerned a future Board might try to deny him those benefits. Grasso asked, "What's to prevent a future Board from saying 'that was a different Board'"? While Grasso did not recall discussing this issue with any other directors, at least two other directors recalled Grasso conveying to them a concern along these same lines at some point during the renegotiation process. One director recalled Grasso expressing concern whether he had a valid claim to the deferred compensation and benefits he had built up.

(iii) Grasso Decides to Put the Proposal Off

At some point prior to August 7, Grasso decided to table the **contract** proposal. He explained that he did so because he sensed from the conversations he had had with directors that there would be **concern** regarding the payout. He stated that he called McCall and told him "let's not go forward." Grasso **was** clear – in tabling the proposal, he was not changing his mind regarding the payout, he was simply, "no new contract." He stated that he was not saying it in an adversarial way. Rather, he explained, he was saying "My current contract expires in May 2005. If things are the same and you want me, we can do the same deal at that time" – *i.e.*, "not now, we can revisit the issue when my current contract is up."

According to McCall, he reported to Grasso that he had been receiving negative feedback from the Board about the proposal. Specifically, McCall told Grasso that **several** Board members had told McCall that the proposal was "bad timing" given various things going on at the time, **including**: (1) the **investigation** of specialists at the NYSE; (2) the fact that governance issues were prominently in the news at the time; and (3) the fact that the NYSE's analysis of its own governance was still ongoing, and the SEC was awaiting a report from the NYSE on that topic. Grasso advised McCall that he did not intend to move forward with the contract at that time because he had gotten the sense **from** Board members there may be opposition. Grasso told McCall that he had **received** phone calls **from** a number of directors who had expressed **concern** to Grasso about going forward with his renegotiated compensation package. Grasso also told McCall that he had heard about McCall's calls to these directors. McCall was relieved and told Grasso that this was the right thing to do.


Many directors learned prior to August 7, either through conversations with Grasso or McCall, or through word of mouth, that the contract proposal had been tabled and would not be on the agenda for the August 7 Board meeting. Reaction among directors to the proposal being shelved was generally favorable. Several directors noted that there was a "general sense of relief."

k. August 7, 2003

Grasso **arrived** at the NYSE the morning of August 7 with the understanding that the contract proposal was not going forward.

According to Grasso, early that morning, he spoke separately with two Committee members and told them that he had called off the consideration of the contract at that time. He recalled they both had similar reactions. They told him they thought it was a mistake and that they would speak to McCall about it.

(i) Compensation Committee Meeting



The Compensation Committee met at approximately 8:00 a.m. In attendance were McCall (Chair) and directors Allison, Fink, Karmazin, Levin and Schrempp. Ashen was also present.¹⁴⁰ At this meeting, the issue of the proposed amendment to Grasso's employment contract was raised, despite not being on the meeting agenda.¹⁴¹ At the outset of the meeting, McCall reported that, as a result of calls he had received from Board members expressing opposition to the proposed contract, Grasso had elected not to proceed with the proposed contract at that time. Thus, McCall explained, the proposal had been tabled and would not be presented to the Board that day. McCall also reported to the Committee that Grasso had conveyed to him that he had no intention of leaving the NYSE.

A long discussion ensued among members of the Committee. Holdover Committee members strongly objected to putting off the proposed new contract and argued that it should be presented to the Board that day. Among other things, they contended that the proposal should proceed because failure to do so would show the public a lack of support for Grasso by the Board, which they did not believe was in the best interests of the NYSE. They also argued that, if the \$139.5 million was due to Grasso, as they had been told, then it was better to pay it out and disclose it at this point than waiting for it to perhaps grow higher. In addition, the Committee discussed that, according to Mercer's analysis, the proposal was financially beneficial to the NYSE.

The Committee then directed Ashen to find Grasso and bring him to the meeting. Ashen said that he then left the Committee meeting and went to Grasso's office to tell him his presence had been requested at the meeting. The Committee continued to discuss the issue at this time. Grasso said he was in his office when Ashen came and told him the Committee wanted to see him. Ashen informed Grasso that a number of Committee members thought it was a mistake to call off the proposal and wanted to go forward. Grasso stated that he was not surprised because of the conversations he had earlier that morning with the two Committee members.

When Grasso arrived at the meeting, the Committee explained to him that it wanted to go forward with the proposal, and wanted to hear his point of view. Grasso stated that he told them he sensed several directors were concerned regarding the publicity that would likely result from the large payout, and thus he had told McCall to put the proposal off. He added that, assuming conditions were the same in May 2005 – that he was in good health and the NYSE still wished to retain him – he would agree to do the same contract at that time. According to Committee members, the Committee asked Grasso if he wanted to proceed with the proposed new contract and Grasso said something to the effect of, "it's up to you." Grasso stated that he was in the meeting for probably less than 15 minutes and was then excused.

After Grasso left the meeting, the Committee voted unanimously to recommend to the Board that the proposed contract be approved. After the Committee meeting ended (at about 9:15 a.m.), Ashen informed Grasso that the Committee had decided to go forward with the proposal and present it to the full Board for its approval at that day's Board meeting.

¹⁴⁰ See NYSE 000029-30.

¹⁴¹ See NYSE 012951.

(ii) Interval Between Compensation Committee Meeting and Board Meeting

Immediately after the Committee meeting, McCall asked Ashen to prepare for him a set of talking points for a presentation to the Board regarding Grasso's proposed **contract** extension and payout. According to Ashen, because the Board meeting started later that morning, he had only about an hour to prepare something for McCall. According to Ashen, he suggested to McCall that he (Ashen) make a presentation to the Board regarding the proposal, to which McCall responded, "No." Ashen said that he then suggested to McCall that he at least assist him in some way in making the presentation, and McCall again refused.

Ashen then prepared two documents: (1) a **three-page** handout for the **Board**,¹⁴² and (2) a two-page document outlining "Speaking Points" for **McCall**.¹⁴³

The handout **was** comprised of the first page of the "Conclusions" in Mercer's July report (page 13), which set forth the makeup of the \$139.5 million payout, and a two-page document, entitled "Source of Funds," which showed "the sources of funds that would be paid to the Executive in September 2003 should the agreement approved by the Committee be approved by the Board of Directors." The handout made no mention of the approximately \$48 million in future payments that would be due Grasso under the terms of the proposed **contract**.¹⁴⁴

The Speaking Points, which Ashen stated he had only about 15 minutes to generate, summarized the amounts to be paid to Grasso under the proposed **contract**. In addition to outlining the \$139.5 million, the Speaking Points addressed the future payments to be made to Grasso under the terms of the proposed **contract**. Specifically, the Speaking Points set forth:

- Under the heading **Regarding Dick's SEW Benefit**: "The Exchange will pay to Dick his vested SERP benefit that has been accrued to date on the NYSE's balance sheet in September 2003 (\$51.6 million) and the amount that is accrued each year (\$7.1 million in 2004, 2005, 2006, 2007)."
- Under the heading **Deferred Compensation**: "Each year the Exchange will pay Dick **his** SESP deferral and the company match (\$144,000) and the portion of the CAP account that becomes vested."

According to McCall, the handout Ashen created before the Board meeting was made up of **pre-existing** documents. Although McCall could not recall the precise date the "Sources of Funds" document was created, he said that he had asked Ashen to prepare it at a time prior to Grasso having tabled the proposed contract, when McCall believed the Board was going to consider the proposal on August 7.

¹⁴² See NYSE 000045-47.

¹⁴³ See NYSE 000043-44.

¹⁴⁴ Pursuant to the amendments to Grasso's employment **agreement**, Grasso was to receive, in September 2003, a payout of \$139.5 million. In addition, according to the September 9, 2003 letter from McCall to Donaldson, the amendments to Grasso's employment agreement also called for Grasso to receive approximately \$48 million in additional future compensation over the next four years, through 2007, in three components, as follows: (a) the accrued and **earned**, but not yet expensed, balance of Grasso's supplemental retirement benefit in the amount of about \$7.138 million per year from 2004-2007 (\$28.6 million); (b) the **unvested** amounts that have **previously** been credited to him as they become vested in **accordance** with the CAP on his 57th through 60th birthdays in 2004-2007 (\$12.1 million); and (c) a **special** retention **payment** awarded for 2000 in the amount of \$5 million (plus interest at 8% per annum from February 1, 2001) on February 1, 2006, if Grasso is employed at the NYSE on that date (approximately \$7 million).

During the interval between the Committee and Board meetings, Ashen also called Mischell of Mercer and **informed** him the proposal was going forward that day and that "we're going to the Board in 20 minutes." Mischell, who was at his office in Princeton, New Jersey, told Ashen he could not make it to the meeting. (Mischell had originally been invited to attend the August 7 Board meeting but was told, prior to August 7, that the proposal had been put off, and, thus, he did not need to attend the meeting.)

Shortly before the Board meeting, Ashen gave the Speaking Points and handouts to McCall. Ashen said he again offered to make a presentation to the Board about the **contract** proposal, but McCall again declined.

(iii) Board Meeting

The Board meeting began at approximately 10:30 a.m.¹⁴⁵ McCall presided. Present were directors **Bartz**, Cayne, **Duryea**, Fagenson, **Harrison**, **Jung**, **Karmazin**, Langone, Larson, **Levin**, **McNamee**, **Purcell**, **Quick**, Schrempp, Sonsini, and Summers. Director Albright attended by phone. After **Grasso** announced the resignation of NYSE Vice Chairman Robert Murphy, he retired from the boardroom.

Ashen then entered the boardroom and passed out to the Board members the handout he had prepared. (The Speaking Points that Ashen had provided McCall were not distributed to the Board at large.) Whether Ashen stayed in the boardroom and answered questions at that point is a subject of some dispute. According to **Ashen**, at the outset of the meeting, McCall made a gesture to him that Ashen felt was a clear signal that McCall wanted him to leave the room, so he left the room. McCall, however, recalled that Ashen stayed at the meeting for a period of time and answered several (10-12) questions regarding the proposed payout. However, not a single Board member, aside from McCall, agreed that Ashen remained in the meeting other than to distribute and collect the NYSE handouts (at the beginning and end of the meeting).

Notes from the Office of the NYSE Corporate Secretary taken on August 7 indicate that Ashen was at the meeting for about **8 minutes**.¹⁴⁶ Notably, two directors specifically recalled that, not only was Ashen not in the meeting, but when one of them leaned over and quietly suggested to McCall during the meeting that Ashen be brought in to help explain the contract proposal, McCall refused to do so.

McCall began addressing the proposal and by most accounts **struggled** in explaining it. McCall provided the Board a short **overview** of the \$139.5 million and the contract extension, but he **acknowledged** to us that he never reviewed or used the Speaking Points that Ashen had provided him. Shortly into his overview, McCall was **interrupted** by various Board members who began discussing and arguing **about** the proposed **contract**.

Many Board members commented that McCall did not clearly or adequately explain the terms of the proposed new contract and payout, and appeared to **know** little about them. Many directors stated that there was a great deal of confusion and a tremendous lack of clarity regarding what the precise terms of the proposed contract were.

All agreed that McCall made no mention of the approximately **\$48** million in scheduled future payments due to Grasso under the proposed contract (representing SERP and CAP benefits and payout of Grasso's

¹⁴⁵ See NYSE 024168-77.

¹⁴⁶ See NYSE 027499-501

2001 \$5 million special bonus). All directors also agreed that there was no discussion at the meeting regarding the \$48 million; it never came up at all. In fact, it appears that Board members were led to believe that, pursuant to the contract extension and the payout of the \$139.5 million, there would be no **further** accumulation of SERF benefits or any other **deferred** compensation or benefits.

None of the former or current Compensation Committee members who were present at the meeting mentioned anything about the \$48 million in scheduled future payments. At least three of the Committee members stated that, at the time of the August 7 meeting, they were unaware that Grasso would be owed approximately \$48 million in future payments under the proposed agreement.

The Board engaged in a prolonged (approximately two hours) and heated discussion regarding the contract proposal. During the discussion, numerous arguments were put forth both in favor and in opposition to the proposal. All directors were generally in favor of extending the term of Grasso's contract. The **discussion** and debate centered around whether Grasso should receive the \$139.5 million payout.

Among the main arguments put forth in favor of approving the proposed contract were the following:

- The \$139.5 million was fully due and payable, and it was better to disclose it now than have to deal with a leak or disclosure later.
- Paying the \$139.5 million now actually resulted in a \$2-3 million savings to the NYSE.
- The \$139.5 million could grow to a much larger number and cause **the NYSE** to have to make **a** much larger payout later.

Not paying out the \$139.5 million would show the public that the Board has a lack of confidence in, or support for, **Grasso**.

Among the main arguments put forth in opposition to the proposed contract were the following:

- It was an excessive amount of money. (One director stated that he argued that \$139.5 million was simply too much money, but abandoned this argument after the Compensation Committee members responded that this issue had already been decided and that Grasso was legally entitled to the whole payout under his contract.)
- The payment of the money now would bring the NYSE and Grasso into disrepute and show a lack of moral compass and a lack of adherence to the same corporate governance standards that the NYSE imposed on its listed companies and members.

At some point during the meeting, according to some directors, a straw poll was taken as to whether to approve the payout. Though the precise tally of that straw poll is unclear (several directors recalled it being an 11-7 vote, while others either recalled a different vote, or had no specific recollection), there were more directors in favor of the proposed payout than there were against it.

Ultimately a vote was taken as to whether to approve the proposed contract terms – both the extension of Grasso's term and the payout. It does not appear, though, that an actual vote was taken. Rather, given the realization among the directors that there were more directors in favor of the proposal than against it, and

after much discussion, the Board agreed to present its approval as unanimous. Some directors who were against the payout stated that, as a condition of their agreeing to present the Board's vote as unanimous, it was agreed that the vote would be presented to Grasso as a vote in favor of the contract extension, with the "strong suggestion" that he not **take** the entire \$139.5 million payment at that **time**.

Following the approval of the proposed agreement, the subject of the disclosure of the agreement was addressed. According to McCall, he made it clear that if the Board was going **to** go ahead with the deal, it needed to be disclosed now (*i.e.*, "quickly") rather than later, though no specific timetable was set. He felt that it was best to get it out publicly and **try** to put the best spin possible on it, rather than have to deal with a leak. The Board agreed and told McCall to handle it.

Grasso stated that he was not in the Board meeting for discussion of the issue of his contract. He described the executive session as "extended" **and** said it probably lasted 90 minutes. At the end of the Board meeting, he recalled, the **Board** invited him into the boardroom and informed him that his new contract had been approved, and congratulated him.

Many Board members who were not previously familiar with the proposal (non Compensation Committee members) left the August 7 meeting with little to no understanding of the contract and payout. In fact, no **draft** contract had even developed at this point. McCall was delegated the authority to execute a contract reflecting a contract extension for Grasso with the payout of the \$139.5 million in deferred compensation and benefits. However, of the directors **interviewed**, some recalled McCall being delegated authority to negotiate the contract, others did not, and yet other directors said they were unclear that McCall was delegated the authority to both negotiate and sign the contract without it being presented first to the Board.

Grasso acknowledged that he had spoken with several Board members since the August 7 Board meeting about what went on in the meeting. He stated that the general substance of those discussions was that there was a varying degree of understanding on the Board – some directors understood the proposal completely and some did not – and that **McCall's** presentation did not fully brief them regarding the proposal. Grasso also said he understood that at the August 7 meeting, McCall had **been** delegated the responsibility of getting the contract together to memorialize the agreement.

Subsequent to August 7, several directors said they called Grasso to try to convince him not to take the payout, and at least one director stated Grasso indicated he would think about it. Grasso stated that, between the August 7 meeting and the signing of the contract on August 27, he did not receive any calls suggesting that, **even** though the Board had approved the payout, he should, in his discretion, turn the payout down. He did, though, recall "a couple of conversations" with one director regarding the negative reaction the disclosure of the payout would bring. That director stated he told Grasso "it's going to cost you your job." He stated that Grasso subsequently told him that, after speaking with Martin Lipton, he had decided to go ahead with the new contract and payout.

I. August 8, 2003 to August 27, 2003

(i) August 12, 2003

On August 12, 2003, the Committee held a meeting during which it discussed the preparation and disclosure of Grasso's new agreement. In attendance were McCall (Chair) and directors Fink, Karmazin and Levin. Ashen was also present. It was decided that once the agreement had been signed by McCall

(on behalf of the NYSE) and by Grasso, it would immediately be disclosed in its entirety. In addition, Ashen was directed to have Proskauer Rose LLP ("Proskauer") begin drafting a new agreement that would reflect the proposal approved by the Board.

Following the meeting, Ashen contacted Ian Levin at Proskauer, who had drafted Grasso's 1999 agreement, and asked him to draft the new employment agreement. On that call, Ashen informed Levin as to the terms of the new agreement. Levin recalled asking Ashen at the time whether the NYSE had obtained a "reasonableness opinion" for the overall level of compensation contemplated under the new agreement, noting that the NYSE might want to obtain such an opinion in order to avoid problems under New York's Not-for-Profit Corporation Law, which required that director and officer compensation be "reasonable." Levin said that Ashen told him that the terms of Grasso's new agreement had been negotiated for months, that Wachtell Lipton, Hewitt, and Mercer had been involved in looking at the terms, and that the law firm of Vedder, Price had given the NYSE a reasonableness opinion. Levin stated that such opinions are typically given by compensation consultants, not law firms, so at the time he found it highly unusual that Vedder, Price had issued the reasonableness opinion. He recalled telling Ashen that Proskauer didn't give reasonableness opinions. Ashen stated to us that he did not obtain a reasonableness opinion, and that he never told Levin or anyone else that he had obtained such an opinion.

In a call later that same day, Levin spoke with Ashen and McCall about the contract. According to Levin, the terms of the contract were not discussed during the call, as Ashen indicated to McCall that he had already briefed Levin on those terms. Levin stated that McCall simply told him something to the effect of "Good, go do it." Levin stated that this conversation with McCall was his only contact with the compensation Committee during the course of drafting the contract.

(ii) August 13, 2003 to August 26, 2003

Between August 12 and August 27, when the contract ultimately was executed, Levin worked on drafting the contract. During this time, McCall was sent numerous drafts of the contract. McCall stated that he talked to Ashen about the contract and that Ashen assured him that the terms of the contract were the same terms that had been addressed and approved at the Committee and Board meetings. McCall stated that relying on Ashen, he did not focus on the details of the drafts. Grasso stated that his dialogue regarding the contract during this time frame was exclusively with his attorney and Ashen. He explained that his discussions with Ashen were purely administrative or logistical in nature, regarding getting the contract done; they did not discuss the terms of the contract, which had been decided by the Board.

In late August, approximately one week prior to the contract being executed and announced publicly, Ashen briefed Robert Zito, the head of Communications at the NYSE, about Grasso's contract. According to Zito, this was the first he had heard about the new contract. He stated that Ashen explained to Zito the terms of the agreement. Specifically, he stated that Ashen told him that, pursuant to the new agreement, Grasso's employment term would be extended to May 2007 and Grasso would receive a salary of \$1.4 million, a minimum target bonus of \$1 million that was not guaranteed, and would be allowed to draw down any funds he had in his savings and retirement plans, which totaled \$139.5 million. Zito also stated that Ashen gave him the two-page memo entitled, "Source of Funds"¹⁴⁷ (which had been distributed as part of the handout at the Board meeting), and told Zito that this memo summarized the \$139.5 million payout. That document made no reference to the \$48 million in future payments due to Grasso under the terms of the new contract.

¹⁴⁷

See NYSE 000046-47.

(iii) August 27, 2003

On August 27, Grasso's 2003 Employment Agreement was **executed**.¹⁴⁸ Grasso **signed** the contract at his home, and noted that when he received it, it had already been signed by McCall on behalf of the NYSE. Grasso stated that he had reviewed the contract and that it accurately reflected his agreement. After the contract was signed, Grasso called McCall to thank him.

McCall admittedly signed the contract without reading it in its entirety. He stated that he signed it based on (1) having been told by Ashen that the bottom line was \$139.5 million, and (2) the Board having been advised that the bottom line was \$139.5 million. The additional \$48 million in future payments owed Grasso under the agreement is set forth in various sections of the agreement. For example, approximately \$40 million of the \$48 million is set forth in charts on pages 4 and 5 of the agreement. Specifically, the agreement set forth two schedules of payments (future SERP and CAP benefits) to be paid Grasso under the new agreement. The **SERP** chart in the agreement showed as follows:

<u>Date</u>	<u>Amount</u>
January 1, 2004	\$7,138,000
January 1, 2005	\$7,138,000
January 1, 2006	\$7,138,000
January 1, 2007	\$7,138,000

The CAP chart in the agreement showed as follows:

<u>Vestine Dates</u>	<u>Amount</u>
Grasso's 57th Birthday (7126103)	\$1,449,822
Grasso's 58th Birthday (7126104)	\$2,950,630
Grasso's 59th Birthday (7126105)	\$3,115,866
Grasso's 60th Birthday (7126106)	\$4,604,921

On this same date, the NYSE issued a press release regarding Grasso's new contract. The press release disclosed the \$1.4 million salary, at least \$1 million target bonus, and \$139.5 million payment of deferred compensation and benefits that were provided for under the terms of the **contract**.¹⁴⁹ The press release made no mention of the \$48 million in future payments to Grasso called for under the contract. **McCall stated that** at this point, **he had no understanding or knowledge of that \$48 million.**

Before the press release went out, Robert Zito, Grasso, Ashen and McCall reviewed it. Grasso stated that the press release had also been sent to him at his home, and noted that he renewed it and "may have word-smithed it a bit, a few words," but made no substantive edits. **Grasso stated that he knew the \$48 million was part of the contract when he signed it and explained that the omission of the \$48 million from the press release was intentional.** He said that it did not need to be disclosed at that time because it was comprised of payments in the future. He stated that he and McCall had a press conference and discussed all that was being paid out in August 2003. He noted that the NYSE had previously decided in June 2003 that executive compensation would be disclosed and that future payments would be disclosed at the time they were made. He recalled this being explained at a September 9 or 10 press conference, and noted that "it was Carl's decision."

¹⁴⁸ See NYSE 000945-69.

¹⁴⁹ See NYSE 033225-27.

Following the August 27 press release, at least one director recalled the Board being faced with "days and days and days of damage control."

m. September 2003

(i) Early September

On September 2, William H. Donaldson, Chairman of the U.S. Securities and Exchange Commission, sent a letter to McCall after the NYSE announced on August 27, 2003, the unanimous approval of Grasso's 2003 agreement.¹⁵⁰ In the letter, Donaldson wrote that, "In my view, the approval of Mr. Grasso's pay package raises serious questions regarding the effectiveness of the NYSE's current governance structure." He further wrote that, "[T]o better assess the steps that the NYSE has taken to date with respect to its governance processes, we need full and complete information about the procedures and considerations that governed the award of Mr. Grasso's pay package." The letter further enclosed a two page list of questions regarding the terms of the pay package and related items and the process of their approval, and requested supporting documentation related thereto. McCall, Grasso, Ashen, and Ashen's staff spearheaded the NYSE's response to Chairman Donaldson's letter.

On or about September 2, Grasso received payment (in two installments) of the \$139,486,000 provided for under the 2003 contract.¹⁵¹

In early September, the issue of the at least \$48 million owed Grasso in future payments, unknown to most Board members before this time, began to surface.

Shortly after September 2, many Board members learned of the \$48 million for the first time in connection with the NYSE's preparation of its response to the SEC's September 2 letter. In early September, Grasso met with several directors who expressed that they were unaware that Grasso was owed at least an additional \$48 million in future payments under the 2003 agreement. Grasso stated he had believed they all knew about this matter because he thought it was in the presentation and materials McCall had given the Board on August 7. Grasso then asked Ashen to give him what he had given McCall at the Board meeting. (He stated that, at or around this time, Ashen showed him the handout from the August 7 Board meeting. Grasso also stressed that Ashen had given McCall a term sheet in June that set forth all of the contract terms.)

(ii) September 5, 2003

According to McCall, on September 5, 2003, he was at the NYSE to attend a meeting of the Special Committee on Governance. Just prior to the meeting, McCall was called into Grasso's office, with Ashen present, and Grasso said that he was entitled to an additional \$28 million in future payments which would have to be disclosed in the SEC response letter. McCall said that he had never heard about the \$28 million, but Ashen and Grasso responded that it had been disclosed to and discussed with McCall. According to McCall, neither Grasso nor Ashen said anything at that time about another \$20 million in future payments that were part of the \$48 million.

¹⁵⁰ See NYSE 054560-63.

¹⁵¹ See NYSE 029897-99, 024601-05

McCall stated that, at the Governance meeting, the issue of the additional \$28 million was raised. When asked by one director whether there was any more money owed Grasso, McCall stated that Ashen responded that there was another \$20 million in future payments as well.

Grasso stated that he was in attendance at the September 5 Governance meeting. He specifically recalled the \$28 million (or the \$48 million) coming up. He stated that he did not think the full \$48 million was discussed at that meeting, as he thought the additional \$20 million was only raised subsequently. Grasso recalled that a number of directors indicated it was first time they heard of these future payments. He noted McCall "couldn't have possibly" been hearing it for the first time.

After the Governance meeting, McCall said he was again asked into Grasso's office. Already present with Grasso were Ashen, Lipton, and Langone. Grasso also recalled meeting with McCall, Lipton, Ashen and Langone in his office on the day of the Governance meeting. McCall said that Grasso told him that he felt he should take the \$48 million because he felt that not doing so would disparage and undermine the process of the Committees and Boards that had gone through the review and approval process and endorsed the agreement.

According to Grasso, they discussed the fact they would have to disclose the additional \$48 million in the NYSE's response to the Chairman Donaldson's letter. He recalled McCall (at that meeting or another) professing that he did not know there was another \$48 million, even though it was in the contract. Grasso recalled telling McCall that it was clearly laid out in the contract and that "if we changed anything, it would be a repudiation of the whole contract." Grasso stated that Lipton also said that any change would be a repudiation of the contract, and that Langone and Ashen just agreed.

Grasso's recollection was that McCall was uncomfortable with the disclosure of the \$48 million, but did not ask him to forego taking the money. McCall said he strongly suggested that Grasso not take the \$48 million, but Grasso indicated that he would take the money and the others supported him. McCall said he also advised Grasso not to take the \$48 million in a subsequent conversation they had, and that he explained to Grasso that he believed taking the \$48 million would be damaging to Grasso personally.

(iii) September 8, 2003

A Compensation Committee meeting was held on September 8 to discuss the events that had taken place since the NYSE announced Grasso's 2003 contract, and to discuss how to respond to the SEC's inquiry surrounding Grasso's 2003 contract and compensation.¹⁵² In attendance were McCall (Chair) and directors Allison, Fink, Karmazin and Levin. Also in attendance was Ashen. The Committee voted not to recommend renegotiation of the contract, and to immediately disclose to the public the response as well as the agreement.

(iv) Directors' Reactions to the \$48 Million in Future Payments

Several directors recalled receiving a call from McCall prior to the September 9 Board meeting advising them that there was a problem and saying that he had just learned of an additional \$48 million in future payments owed Grasso under the 2003 contract. Other directors said they learned of the additional monies owed Grasso through phone conversations with other Board members who themselves had just

¹⁵² See NYSE 000037-38.

learned of the issue. Yet other directors first learned of the additional \$48 million when they received the draft response to the SEC on September 8 or 9.

There was a general sense of disbelief amongst directors in learning that Grasso was owed at least an additional \$48 million in future payments under the 2003 agreement. Some directors expressed anger over the fact that they had not been advised of any future payments at the August 7 Board meeting and had in fact been told that the \$139.5 million was the sum total of what was to be paid to Grasso in deferred compensation and benefits. There was also a general feeling that this additional money would be a huge problem given that the NYSE had just issued a press release which made no mention of the \$48 million in future payments owed Grasso under the 2003 contract.

n. September 9, 2003

On September 9, a telephonic Board meeting was held, at which the Board discussed the NYSE's response to the SEC's September 2 letter and the \$48 million in future payments provided for in Grasso's 2003 employment agreement.¹⁵³ Chairman Grasso presided. Present were directors Albright, Allison, Britz, Cayne, Duryea, Fagenson, Fink, Harrison, Jung, Karmazin, Kinney, Langone, McCall, McNamee, Mack, O'Neal, Paulson, Purcell, Quick, and Sonsini. Others present included Ashen and Lipton. A draft response to the SEC's letter, and exhibits thereto, had been prepared and circulated to the Board the prior evening, though not all directors received the exhibits.

Included in the draft response was reference to the \$48 million. All agreed that when directors saw Grasso was entitled to future payments, many expressed surprise and dismay in response to this disclosure.

According to some directors, as well as notes of the meeting, during the call, Lipton stated that he had reviewed the NYSE's draft response and commented that the \$48 million in future payments provided for under the 2003 agreement had been earned by Grasso and was legally his.¹⁵⁴

The Board then went into Executive Session, at which point Grasso and Lipton left the call. A discussion ensued regarding whether to demand that Grasso not take the \$48 million. Prior to the Board reaching a conclusion on the issue, Grasso interrupted the Executive Session and announced he had decided to forego receipt of the \$48 million.¹⁵⁵ Grasso was praised by the Board for his decision.

The minutes of the September 9 meeting reflect that "Chairman Grasso informed the Board that he had determined to forego receipt of his remaining prior earned compensation, thereby foregoing the future

¹⁵³ See NYSE 024268-69.

¹⁵⁴ See NYSE 032817, 029237.

¹⁵⁵ Grasso stated that, while off the Board call, he phoned Lipton because he sensed that the Board was very uncomfortable regarding the disclosure of the additional \$48 million. He stated that he told Lipton he was going to go back on the call and say he would not take the \$48 million. According to Grasso, he simply shared with Lipton that he had made that decision. Grasso explained that Lipton responded, "I don't think that's a good idea." He indicated that he understood why Grasso was doing it, and even said that people on the Board call were uncomfortable with the \$48 million. According to Grasso, Lipton believed that Grasso was entitled to the \$48 million. Grasso noted that Lipton may have been on the call with him and the Board call at same time. Grasso explained that he then dialed back into the call and said to the Board that he recognized their discomfort and that people had been confused and, therefore, he had decided to "forego" the \$48 million. He stated that he thanked the Board and that the directors were genuinely appreciative.

payments of approximately \$48 million.”¹⁵⁶ (Draft minutes of the September 9 meeting reflect that Grasso determined he would forego the \$48 million and that “[t]he Employment Agreement will be revised accordingly.”)¹⁵⁷ Ian Levin stated that, subsequent to the September 9 Board meeting, he was contacted by Ashen about drafting an amendment to Grasso's contract memorializing the waiver. Levin said that he drafted the amendment, but that it had not been forwarded to the NYSE because he never heard back from Ashen as to who it should be sent to.

After the meeting, McCall signed the NYSE's response letter to the SEC. That letter included the following statement: "Mr. Grasso has informed the Board of Directors that he has determined to forego receipt of [the \$48 million].”¹⁵⁸ (Grasso stated that he understood the response would reflect what he had said in this regard.) The submission was prepared by Grasso and the entire staff, and was signed by McCall in Grasso's office. Grasso himself served as the principal contact with the SEC. All of the materials sent to the SEC were then made available to the press. A press conference was held, with McCall and Grasso present. McCall stated that, while the NYSE's August 27 press release had indicated that the Board approved a \$139.5 million payout to Grasso in connection with his 2003 employment agreement, the NYSE's response to the SEC indicated that there was another \$48 million in payments due Grasso under that agreement, but that Grasso had foregone receipt thereof.

o. September 17, 2003

(i) Scheduling of the September 17 Board Meeting

On September 17, 2003, a telephonic Board meeting was conducted at Grasso's behest. Grasso stated that he called this Board meeting because there had been an enormous media and political call for him to step down. He recalled that on September 17, two State treasurers and two Democratic Presidential candidates (Joseph Lieberman and John Edwards) had called for his resignation. Because the Board had given their unanimous support to him on August 27 and September 9, he wanted the Board to hear about these calls for him to step down and to reflect their thoughts. Grasso was also concerned about press reports that certain directors were having side meetings in an effort to force him out.

(ii) Board Meeting

The telephonic Board meeting commenced at approximately 4:15 p.m.¹⁵⁹ Chairman Grasso presided. Present were directors Albright, Allison, Bartz, Britz, Cayne, Duryea, Fagenson, Fink, Harrison, Jung, Karmazin, Kinney, Langone, Levin, McCall, McNamee, Mack, Paulson, Purcell, Quick, Sonsini and Summers. Others in attendance included Ashen and Lipton.

At the outset of the meeting, Grasso read the following written statement to the Board, which had been drafted by his attorney and edited by Grasso:

I want to start by saying that I have tried to analyze the current situation from as many perspectives as I can objectively, and while I say this with the deepest reluctance, the best

¹⁵⁶ See NYSE 024268-69.

¹⁵⁷ See NYSE 04804143.

¹⁵⁸ See NYSE 000001-12.

¹⁵⁹ See NYSE 024258-60.

alternative, it seems to me, is that I should submit my resignation at the next board meeting if you wish me to do so, for the benefit of the NYSE and to help preserve what we have **tried** together to build over the last 35 years and I look forward to supporting the Board and the NYSE in bringing about a smooth transition to a successor management **team**. I believe this course is in the best interest of both the NYSE and **myself**.¹⁶⁰

Grasso noted he also told the Board about the various statements and calls for his resignation that had been made by politicians and State treasurers. At 4:22 p.m., Grasso left the call as did **Britz**, Kinney, Ashen and **Lipton**.

Following Grasso's announcement, the Board went **into** Executive Session. With **McCall** presiding over the meeting, a long discussion ensued regarding the issue Grasso had presented.

Ultimately, by a vote of 13-7, the Board decided to accept Grasso's resignation.

E. The Structure/Functional Operation of the NYSE as It Relates to Issues Regarding Grasso's Compensation

As part of our Investigation of matters relating to Grasso's compensation, we examined several aspects of the NYSE's structure and functional operations **that**, for various reasons, became relevant to compensation issues.¹⁶¹ The information we learned concerning these aspects of the NYSE is set forth below.

1. Board Appointments

During his tenure as Chairman and CEO, Grasso had significant input as to the composition of the NYSE Board of Directors. Although the NYSE had an independent Nominating Committee responsible for electing Board members, Grasso had significant input with respect to the composition of the Nominating Committee and was instrumental in determining the composition of the Board.

Throughout Grasso's tenure, pursuant to Article V of the NYSE Constitution, the Nominating Committee was comprised of eight members, four of whom satisfied the definition of public director, and four of whom satisfied the definition of industry director. Members of the Nominating Committee were selected by the current Nominating Committee. The NYSE Constitution provided that, in selecting members of the Nominating Committee, the Committee was to consider "representatives from all Exchange constituencies, taking care to avoid having any undue concentration of such nominees from any one area or industry." The Constitution further provided that the Nominating Committee be divided into two classes, with each class consisting of two public and two industry persons, whose terms shall expire in alternate years. The Chairman of the Committee is elected annually, with the Chairman alternating year-to-year between a public person and an industry person.

The Constitution expressly provided for the Committee to act independently of the Board. The Constitution stated that the "Board shall have no control over or power with respect to the Nominating Committee," and further provided that no directors shall be eligible to serve on the Committee. However,

¹⁶⁰ See NYSE 002878

¹⁶¹ Due to time constraints, our investigation of some of these issues was not as detailed as our investigation of Grasso's compensation issues.

the Nominating Committee was not prevented from soliciting the views of the Chairman or other members of the Board.

The main purpose of the Committee was to come up with a slate of nominees to recommend to the Board, present the slate to the Secretary of the Exchange who, upon receipt, notified the members of the Exchange of the names of such nominees. In selecting nominees, the Committee sought nominees "committed to serving the interests of the public and strengthening the NYSE as a public securities market."

While Chairman and CEO, Grasso took an active role in the affairs of the Nominating Committee and provided direct input into the composition of the Committee. Grasso kept apprised of nominees to the Committee and advised the Committee which nominees he preferred. Often, Grasso's preferred nominees were elected.¹⁶² Grasso also provided input regarding which member would serve as the Committee's Chair.¹⁶³ One former director even referred to the Nominating Committee as being "basically his team."

Through his interaction with the Nominating Committee, Grasso also heavily influenced who was appointed to the Board. During Grasso's tenure, the NYSE Constitution provided that the Board consist of 24 directors elected by the members of the NYSE, a Chairman of the Board, the Executive Vice Chairman, if there be one, and the President, if there be one. The Constitution further provided that Directors consist of twelve public and twelve industry directors, divided into two classes of twelve each (six public and six industry directors), whose terms of office expired in alternate years. The Constitution further prescribed parameters for both public and industry directors. Directors were prohibited from serving more than three consecutive terms.

Grasso took an active role in the selection of Board members. The NYSE Constitution, Article V, set the procedures to be followed by the Nominating Committee and provided for the Chairman of the Board to have a consultative role to the Committee: "[T]he Chairman of the Board shall meet with the Nominating Committee prior to March 1 of each year to report on the needs of the Board and to provide any other information relevant to the work of the Nominating Committee." Grasso, as a matter of course, was significantly more involved than provided for under the Constitution.

Grasso made it clear to the Committee that he believed it was important for the CEOs of the top five or six financial firms to serve on the Board. While it is not a requirement for Board members to be CEOs, Grasso made a point of recommending that only CEOs of organizations be appointed to the Board. Grasso would give the Committee a range of names to fill vacancies. It appears that, in practice, Grasso selected many on the Board members by referring to the Nominating Committee candidates whom Grasso wanted to have on the Board and the Nominating Committee then approved those choices.¹⁶⁴

As a result of Grasso having influence both as to the composition of the Nominating Committee and the Board, in Grasso's later years as Chairman – years when his compensation reached very high levels – he had a hand in selecting the Board members who decided on his compensation.

¹⁶² See NYSE 004104-05, 004027-28.

¹⁶³ See NYSE 006775-78, 003540-41, 008333-34.

¹⁶⁴ See NYSE 003382, 006637-41, 006944-45, 006787-88, 007154-60, 003325-26, 004130-31

2. Compensation Committee Appointments

Not only did Grasso have significant input in the selection of Board members throughout his tenure; he also had the unfettered authority to select which Board members served on the Compensation Committee and, likewise, to select the Committee Chair. Thus, Grasso hand-selected the members of the Committee charged with reviewing and recommending his yearly compensation.

Members of the Compensation Committee at the NYSE were appointed in June of each year, at the same time that all other committee assignments were made. Pursuant to the charter under which the Committee operated since 1995, members of this Committee were appointed by the Chairman and approved by the Board, with the Chairman selecting the Chair of the Committee:

RESOLVED, that the [HUMAN RESOURCES] POLICY AND COMPENSATION COMMITTEE shall consist of such number of Directors as shall be appointed by the Chairman and approved by the Board, one of whom shall be selected by the Chairman to serve as presiding member."

Grasso **acknowledged** that, each year, he made his recommendations to the Board concerning Committee assignments, including his recommendations regarding the Compensation Committee. Grasso could not recall a single instance in which the Board rejected one of his Committee assignment recommendations. Thus, in **practice**, Grasso directly controlled **not** only which Board members **served** on this Committee, but also which person would serve as the Committee's Chair.

Several members of the Committee during Grasso's tenure had friendships or personal ties or relationships with Grasso, including Charles **Bocklet**, David **Komansky**, Robert Murphy, Ken Langone and Richard Fuld.

Also, during the years 1999-2002, when Grasso was awarded extremely high levels of compensation, members of the Committee earned large compensation awards at the organizations where they worked. According to Johnson Associates, **Inc.**, in 1999, the four Committee members for whom compensation information was available earned roughly \$11 million, \$19 million, \$21 million, and \$35 million, for an average of over \$21 million. In 2000, four of the five Committee members on whom we were able to obtain compensation information earned over \$34 million, and the average earnings of that group was about \$34 million. In 2001, Committee members as to whom we obtained earnings information averaged over \$25 million in earnings and, in 2002, the average was about \$20 million. Some directors we interviewed believed that the large amounts of compensation earned by many Committee members made the Committee in general less concerned about awarding large compensation amounts to Grasso.

A number of the Committee members said that, because of their important job responsibilities in the business community, they were reluctant to join the Board and had to miss Committee or Board meetings **from** time to time. By way of example, one director stated that, at the time he was asked to join the Board, he had a conversation with Grasso about how much of a time commitment **servng** as an NYSE Director would entail and stated that he had no interest in going to a lot of meetings or doing a lot of work. He was assured by Grasso that he did not have to attend all the meetings and that it would not be that much work. He was placed on the **Compensation** Committee.

¹⁶⁵

See NYSE 000186-87.

Yet another director explained to Grasso when asked to join the Board that he was extremely busy and thus would not be able to attend many Board meetings. He, too, was placed on the Committee. Another Committee member who displayed poor attendance stated that he explained at the outset that his other duties would at times interfere with his ability to attend meetings for the NYSE. Several members of the Committee had relatively poor records regarding their attendance at meetings.

Over the years, the Committee experienced frequent turnover.¹⁶⁶ While some Committee members served for a number of years, others served for only one or two years. In addition, most Committee members agreed that their training was fairly limited. Thus, their historical perspective and knowledge of the NYSE was often somewhat limited.

3. Compensation of Certain Other NYSE Employees

During the course of our investigation, the compensation of certain other NYSE employees became relevant. Specifically, we examined certain aspects of the compensation of Grasso's next most senior officers: COO and President, William R. Johnston, and Group Executive Vice Presidents (and later Co-Presidents), Catherine Kinney and Robert G. Britz. We also examined the compensation of Grasso's staff.

a. Compensation Levels of Johnston, Britz, and Kinney

In the period from 1999 through 2002, Grasso's actual compensation far exceeded the compensation awarded to Johnston, Kinney and Britz, as shown on the chart below.

Year	Grasso	Johnston	Kinney	Britz
1999	\$ 11,300,000	\$4,425,000	\$ 1,647,000	\$ 1,722,000
2000	26,800,000	5,090,500	2,322,957	2,332,957
2001	30,550,000	5,800,000	4,200,000	4,200,000
2002	11,999,999	N/A	3,700,000	3,700,000

In addition, during this period, the Compensation Committee followed its own benchmarks much more closely with respect to awarding compensation to Johnston, Kinney and Britz than it did when awarding compensation to Grasso. The disparity is shown in the following charts.

1999¹⁶⁷

Officer	Benchmark	Actual Comp.	%
Grasso	\$6,984,000	\$11,300,000	162
Johnston	\$3,672,000	\$ 4,425,500	121
Kinney	\$1,596,000	\$ 1,647,000	103
Britz	\$1,596,000	\$ 1,722,000	108

¹⁶⁶ See Exhibit 3, list of Committee and Board members during Grasso's tenure, by year

¹⁶⁷ See NYSE 054142,042409-1 1.

2000¹⁶³

Officer	Benchmark	Actual Comp.	%
Grasso	\$11,087,607	\$26,800,000	242
Johnston	\$ 3,923,834	\$ 5,090,500	130
Kinney	\$ 2,010,305	\$ 2,322,957	116
Britz	\$ 2,010,305	\$ 2,332,957	116

2001¹⁶⁹

Officer	Benchmark	Actual Comp.	%
Grasso	\$18,623,060	\$30,550,000	164
Johnston	\$ 6,782,707	\$ 5,800,000	86
Kinney	\$ 4,725,866	\$ 4,200,000	89
Britz	\$ 4,725,866	\$ 4,200,000	89

2002¹⁷⁰

Officer	Benchmark	Actual Comp.	%
Grasso	\$13,919,838	\$11,999,999	86
Kinney	\$ 5,424,376*	\$ 3,700,000	68
Britz	\$ 5,424,376*	\$ 3,700,000	68

* This benchmark is based on an average median target for the Group Executive Vice President and Chief Operating Officer levels.

b. Large 2001 Award to Johnston

In 2001, the Board voted to award Johnston a \$6 million payment as a parting bonus when he stepped down as NYSE President at the end of 2001.¹⁷¹ Johnston was a non-management Board member from 1992 to June 1996, was President of the NYSE and a staff Board member from July 1996 through 2001, and then became a Special Advisor to Grasso in 2002.

Under his employment contract that was in place at the time, Johnston was slated to receive a \$1 million payment after his contract expired at the end of 2001.¹⁷² In about the middle of 2001, however, Grasso asked the Compensation Committee to award Johnston a payment of \$6 million in lieu of the \$1 million payment.¹⁷³

¹⁶⁸ See NYSE 054064,044092-93

¹⁶⁹ See NYSE 053980, 043780-81.

¹⁷⁰ See NYSE 053928,046051,031612,031538-39

¹⁷¹ See NYSE 029682-83, 023763-64.

¹⁷² See NYSE 030209-35.

¹⁷³ See NYSE 059564-85.

This payment, according to Grasso, Johnston, and others was (1) in thanks to Johnston for his past years of service at the NYSE; and (2) in recognition that, when he joined the NYSE in 1996, Johnston left behind equity interests in his former firm, LaBranche & Co. LLP, and that, had he stayed at LaBranche, he would have made a lot of money when LaBranche went public in 1999 and its stock price subsequently rose significantly.

c. Grasso Support Staff

Over the last three years, Grasso's executive assistant was paid approximately \$240,000 per year.¹⁷⁴ In 2002, her salary was \$188,700 and her bonus was \$75,000. In 2001, her salary was \$170,000 and her bonus was \$85,000. In 2000, her salary was \$150,000 and her bonus was \$60,000. Grasso also used the services of two drivers on the NYSE payroll, each of whom earned approximately \$130,000 per year.¹⁷⁵

4. NYSE Charitable Contributions¹⁷⁶

In its September 2, 2003 letter to the NYSE, the SEC inquired into the relationship between the NYSE's charitable giving and Grasso's compensation. Specifically, the SEC sought information concerning the NYSE's contributions to charities that were affiliated with members of the NYSE's Compensation Committee. In our investigation, therefore, we have sought to determine if there is any evidence to support an allegation that decisions about Grasso's compensation were influenced by or connected to the NYSE's gifts to charities affiliated with Compensation Committee members.

The NYSE makes charitable donations through the NYSE Foundation ("Foundation") and the NYSE Contributions Committee ("Contributions Committee"), and each has processes for its charitable giving.¹⁷⁷ During Grasso's tenure as Chairman and CEO, both the Foundation and Contributions Committee at times donated money to charities that were connected in some way with Compensation Committee members. However, we have found no direct evidence that these donations were given for the purpose of influencing directors' decisions on Grasso's compensation, or that they had any effect on the Committee's compensation decisions. Nor did we find sufficient circumstantial evidence to support such an allegation.

We describe below the Foundation and Contributions Committee, their processes for making donations and some of the scenarios in which the NYSE has given money to charities that were affiliated with Compensation Committee members.

¹⁷⁴ See NYSE 054558-59.

¹⁷⁵ See NYSE 054557.

¹⁷⁶ Our investigation in this area was limited in several respects. For example, we could not subpoena documents from charitable organizations that received donations from the NYSE. Nor did we interview any representative from these organizations. In addition, most of the information we reviewed is from a database maintained by Wheeler of all charitable contribution requests by the NYSE. We have not attempted to independently verify whether the information in that database is accurate. Nor have we independently investigated each Compensation Committee member's charitable affiliations. Instead, we relied on the 1995-2003 biographies contained in the annual Directors Manuals distributed to each NYSE director.

¹⁷⁷ The NYSE also makes charitable donations through the NYSE Fallen Heroes Fund, which was created in 1999 as an Internal Revenue Code ("IRC") § 501(c)(3) public charity. The Fallen Heroes Fund has paid a one-time grant of \$20,000 to the surviving spouse and/or children of a New York City police officer, firefighter or emergency medical technical who was killed in the line of duty.

During Grasso's tenure as Chairman and CEO, requests for donations typically were submitted in writing to the Foundation or Contributions Committee and addressed to **Grasso**, the Secretary of the Foundation (Robert T. Zito and, before him James Buck) or other **individuals** affiliated with the Exchange. These requests came from various sources. Some contribution recommendations came from NYSE officers or employees, who generally had a business purpose for the requested donation. Other requests came from NYSE directors, who typically **recommended** donations to charities with which they were affiliated. And still other contribution requests were unsolicited.

As a control mechanism to avoid duplicate or conflicting payments, all contribution requests considered by the Foundation or the Contributions Committee were routed through NYSE Archivist Steven Wheeler for screening, processing and payment. Wheeler maintains a database of all charitable contribution requests for donations submitted to the Foundation and the Contributions **Committee**, as well as all charitable contributions by these organizations.

The NYSE has conducted internal audits of both the Contributions Committee and the Foundation. The last audit was in 2000.¹⁷⁸

a. The Foundation

The NYSE Foundation is a private foundation created in 1983 that has its own board of directors, by-laws, **annual** reports and **guidelines**.¹⁷⁹ NYSE directors are members of the Foundation.

According to the 2003 Foundation Contributions Guidelines, the Foundation "will make contributions, within the limits of its available resources, in support of worthy educational, charitable and civic organizations which are exempt from taxation under **501(c)(3)** of the Internal Revenue Code of 1954."¹⁸⁰ The guidelines further state: "By careful selection, The Foundation will seek to ensure the meaningfulness of its contributions in the areas where the New York Stock Exchange has a responsibility to be a participatidg corporate citizen." In general, the Foundation "will support proven education, charitable and civic programs as well as significant new programs in these areas. The Foundation will contribute to major educational and artistic institutions in New York City as the Exchange has done in the past." These guidelines contain no general dollar range for contributions.

Most Foundation grants have represented annually **recurring** support to **well-known** educational, quality of life and community organizations. Additionally, the Foundation's Matching Gift Program **has** matched the donations of NYSE employees and directors to eligible schools and colleges as well as arts and cultural organizations.

As indicated above, the Foundation is served by its own board of directors, which is responsible for approving Foundation grants and managing its finances and administration. The Foundation's by-laws state that the board can consist of between five and thirteen directors, who are elected by the NYSE Board each June." The Foundation board has met at least four times a year (always in **conjunction** with a NYSE Board meeting), and minutes are kept of these meetings.

¹⁷⁸ See NYSE 013317-23.

¹⁷⁹ See NYSE 013558-79,013717-18,013317-23.

¹⁸⁰ See NYSE 013717-18.

¹⁸¹ See NYSE 013579.

The following directors served on the Foundation's board during Grasso's tenure as **Chairman** and CEO: Carol Bartz (2002-03), Geoffrey Bible (1996-2000), Benjamin Griswold, IV (1996-98), William B. Harrison, Jr. (2001-03), A. James Jacoby 1996-97), William Johnston (1996-2001), Joseph Mahoney (1999-2002), Deryck Maughan (1997-2000), George C. McNamee (2000-03), Robert Murphy (2002-03), Leon Panetta (1998-2002), and Christopher C. Quick (2003). These directors also served on the NYSE Board, but there is no requirement that this be the case.

Zito served as the Foundation's Secretary, Keith Helsby as its Treasurer, Alan **Holzer** as its Controller and Ken Corson provided legal counsel. Grasso did not serve on the Foundation's board during his term as Chairman and CEO, but he did serve on the board in the mid-1980s.

Contribution requests sent to the Foundation followed a specific protocol. Wheeler and Zito generally reviewed together such requests in the first instance. Zito had authority to decline requests that did not fit within the Foundation's guidelines or were not consistent **with** the NYSE's business needs. New contribution requests that fit within the guidelines and supported the mission of the Foundation were referred to its board for consideration at a subsequent meeting (usually in June, October and December).

Grasso had no formal role in approving donations by the Foundation. But he did, on occasion, attend meetings and recommend donations. Such recommendations by Grasso typically were sent to Zito with a note "refer to Foundation." Zito **forwarded** such recommendations to Wheeler, who prepared memoranda to the Foundation's board concerning the recommended charities. In preparing these memoranda, Wheeler would **confirm** that the charity was a legitimate § 501(c)(3) public charity and otherwise fit within the Foundation's guidelines.

In **February** 2003, the Foundation board approved an annual Plan of Contributions, primarily prepared by Zito and Wheeler, that authorized grants to be paid as requests come in during the year. Grasso reviewed this Plan before it was submitted to the board but, again, he did not actively approve the Plan because he was not a Foundation board member at this time. When the underlying requests were actually received during the year, Zito and Wheeler reviewed the requests, and Zito generally acted pursuant to his delegated authority to approve "pre-approved" contributions.

The Foundation is funded, in part, by year end contributions by the NYSE.¹⁸² Each year, Grasso's informal policy was to contribute to the Foundation the difference between the anticipated revenue from NYSE disciplinary fines and the charitable disbursements made by the Contributions Committee. The goal of the NYSE was to donate to charities (through both the Foundation and the **Contributions Committee**) an amount roughly equal to the revenue it received from disciplinary fines. The NYSE donations to the Foundation generally totaled between \$1-3 million each year.

The total 2002 NYSE contribution to the Foundation was about **\$2** million. The Foundation's Plan of Contributions for 2003 authorized grants totaling slightly more than \$3 **million**.¹⁸³ The difference between the budgeted \$3 million and the \$2 million contribution from the NYSE will come from the

¹⁸² The NYSE's annual contribution generally has accounted for about 99% of **the** contributions to **the** Foundation. The remaining 1% is divided into two parts. First, NYSE Rule 411 requires member **firms** to contribute funds to the Foundation when they made a profit reporting error. Second, the Foundation has received individual contributions, but these were rare.

¹⁸³ See NYSE 013719-20.

Foundation's corpus (and income earned on that corpus). This corpus is presently valued at approximately \$21.5 million.

b. The Contributions Committee

At the time Grasso resigned, the Contributions Committee was comprised of Grasso and Zito, who acts as the Committee's Secretary (prior to 2002, James Buck was the Secretary). The Committee met informally and worked in consultation with Wheeler and his staff. No minutes have been kept of the Committee meetings, but Wheeler generally took notes at the meetings and documented the pertinent conversations.

The Contributions Committee has donated funds to **IRC § 501(c)(3)** non-profit organizations and also has purchased tables at **fundraising** benefit dinners. Unlike the Foundation, the Committee can receive goods or **services** (generally meals) in **return** for its charitable donations.

According to the 2003 Contributions Committee Guidelines, the **Committee** fulfills the NYSE's "responsibilities as a corporate citizen" by contributing "to qualified organizations which further [the NYSE's] principal purposes or improve the quality of life in the greater New York area." These guidelines define NYSE purposes to "include its role as a marketplace for **securities**, and as a property owner in the lower Manhattan area where most of its employees and members **work**."¹⁸⁴

In general, Contributions Committee donations have been in the range of \$1,000 to \$25,000. The guidelines expressly state, however, that "[c]ontributions smaller than \$1,000 or larger than \$25,000 may be made in exceptional situations." In fact, the Contributions Committee, on multiple occasions, has made contributions over \$25,000.

Like the Foundation, the Contributions Committee followed a general protocol to process requests for donations. Zito and Wheeler together reviewed contribution requests. Based on these discussions, Zito acted pursuant to his delegated authority to deny requests that did not fit within the guidelines or otherwise did not serve the business needs of the NYSE. Zito and Wheeler referred to Grasso, for his review, requests that fit within the Contributions Committee guidelines and appeared to be appropriate for NYSE funding. All approved contributions had to bear the Chairman's written authorization or verbal approval as witnessed and documented by the Committee's Secretary.

As a general policy, Zito and Wheeler forwarded to Grasso requests that, on their face, concerned a NYSE director, such as if the director was an honoree of the charity. Typically, however, Zito and Wheeler did not attempt to determine whether a NYSE director **served** on the boards of charities requesting donations.

Notwithstanding this protocol, Grasso occasionally approved a particular **contribution** before it was even forwarded to Zito or Wheeler for their review. When this happened, Grasso would **write** on the contribution request letter itself a dollar amount reflecting his approved contribution, and he signed his name by this notation.

In May 2003, the Contributions Committee adopted a new procedure under which a "Plan of Contributions" pre-approved donations to organizations and events that the NYSE had generally

¹⁸⁴*See NYSE 013684.*

supported on an **annual** basis. When the underlying requests were actually received during the year, Zito and Wheeler reviewed the requests, and Zito generally acted pursuant to his delegated authority to approve "pre-approved" contributions.

The Contributions Committee is funded by the NYSE, and the NYSE's 2003 budget for the Contributions Committee is \$4 million.¹⁸⁵ This budget, however, can be exceeded for a compelling business reason with the Chairman's consent.

c. Charitable Contributions to Organizations Affiliated With NYSE Directors

According to the NYSE charitable donations database, during the period of 1995 through 2003, the Contributions Committee **and/or** the Foundation made contributions to organizations affiliated with NYSE directors during their respective tenures on the Compensation Committee. **The** following NYSE directors sat on the boards of such organizations: Robert B. Fagenson, Laurence D. Fink, Richard B. Fisher, Richard S. Fuld, Jr., **Maurice A. Greenberg**, David H. Komansky, Kenneth G. Langone, Ralph S. Larsen, Gerald M. Levin, Reuben Mark, Deryck C. Maughan, Henry M. Paulson, Juergen E. Schrempp and Linda J. Wachner. It was also common for Compensation Committee members to be honorees of charitable organizations that received NYSE donations.

No person interviewed in the Investigation provided us with any evidence of a **quid pro quo** or direct connection between the NYSE's charitable donations to these affiliated organizations and Grasso's compensation. To the contrary, most directors dismissed **as** baseless the notion that NYSE charitable **contributions** in any way affected the decisions of Committee members regarding compensation awarded to Grasso. In addition, no document we received in the Investigation provided any direct evidence of any **quid pro quo** or other direct connection involving charitable donations and directors' compensation decisions.

All of the donations under scrutiny appear to have been made to organizations that were of the type that fit within the guidelines of the NYSE **arm** that provided the funding, either the Foundation or the Contributions Committee. In addition, we found no evidence of departures **from** the pertinent guidelines or procedures in processing these requests sufficient to raise questions about the motives underlying NYSE charitable activities. Requests appeared to have been channeled through the processes that were set in place.

For most of the requests, there also was no strong correlation between the timing of the request and the service on the Committee by the Committee member affiliated with the organization that received the funding. In some instances, however, contributions to an organization began or were reinstated once a director who **served** on the board of directors of that organization joined the Compensation Committee. In these instances, however, the contributions were to legitimate charities, and many were of relatively modest amounts.

In other instances, contributions made to organizations on whose boards Committee members served were of a sizable amount. Perhaps the most noteworthy example is the **two-year** planned grant by **the** Foundation on December 7, 2000, of \$500,000 per year to New York University ("NYU") Downtown Hospital to support emergency room renovations. On **December 6**, 2001, the Foundation granted this organization an additional \$500,000. Grasso and other NYSE directors have been affiliated with NYU-

¹⁸⁵

See NYSE 013685.

associated **entities**.¹⁸⁶ None of these directors, however, appears to have sat on the board of trustees for the NYU Downtown Hospital **itself during** the 2000-2001 **period**.¹⁸⁷ Moreover, the NYSE's records show that the **Exchange** had supported this hospital since 1984 because it is "Wall Street's neighborhood hospital," and "the NYSE community is the largest single user of its emergency **facilities**."¹⁸⁸

Finally, in a handful of situations, Committee members appear to have initiated charitable requests that were granted by the Contributions Committee or the Foundation. Such requests, however, were not always granted. And those requests that were granted **concerned** legitimate charitable organizations.

We believe that the connections discussed above between NYSE charitable donations and Compensation Committee members do not constitute evidence of a causal connection between NYSE charitable donations and **Grasso's** compensation. This conclusion is consistent with the unanimous belief by those directors whom we interviewed that no such connection existed. In short, the organizations in question were historical charities supported by the NYSE or otherwise appear to fall within the pertinent contributions guidelines as supporting worthy causes.

¹⁸⁶ See NYSE 054505,054515,005384.

¹⁸⁷ The hospital became affiliated with NYU in or about 1994 and was renamed "NYU Downtown Hospital" in 1997

¹⁸⁸ See NYSE 054516,054507,017404.

not advise the Committee that the comparator group was wholly inappropriate, but instead simply viewed its role as simply providing data and information to the Committee as opposed to **making** substantive **recommendations** to the Committee. Hewitt did not provide advice or substantive input to change the inappropriate benchmarking or to ensure that the Committee was provided with the full range of market data for its analysis.

As noted directly above, compensation experts should be more substantively involved in the executive compensation process at the NYSE.

D. Lack of Transparency/Disclosures Regarding Compensation

Very few people inside the NYSE knew about Grasso's pension accumulation. **Only** Ashen, two of his staff, the top **two financial officers** at the NYSE, and Mercer's Mischell knew of Grasso's pension accumulation, except at the times it was paid out. Grasso's **compensation** awards were not disclosed outside the Board. Not even the other senior executives at the NYSE knew of Grasso's compensation levels.

This lack of transparency in the compensation for Grasso facilitated the compensation and benefits levels' growth to unreasonable levels. Many Board members agreed that, had Grasso's compensation and benefit levels been disclosed outside the Board, they would never have reached such excessive levels. A number of Board members stated that, in **their** judgment, prior to the recent events through which Grasso's compensation has now become known, the members of the NYSE believed that Grasso was probably **making** about \$5-7 million per year in the last few years. Thus, it is clear that a policy of public disclosure of Grasso's compensation would have had a strong effect on keeping Grasso's compensation within reason.

Annual disclosure of top executive compensation, which the NYSE already has implemented under its newly adopted corporate governance practices, should address this issue.

E. Lack of Continuity on Compensation Committee/Board

The NYSE's large Board during Grasso's tenure as Chairman and CEO, coupled with the high level of turnover of Board and Committee members from year to year and the failure to adequately train and share historical knowledge about the NYSE with new Board and Committee members, contributed to a lack of continuity on the Committee and the Board. This lack of continuity resulted in Board and Committee members not **having** a complete frame of **reference** for executive compensation decisions.

Although Ashen stated that he provided some training to new members of the Board, and also walked through compensation-related issues with new members of the Compensation Committee, most Committee members either did not recall much compensation training or did not recall it as being very detailed. Many had no historical perspective on compensation decisions, and were not familiar with the benchmarking processes employed by Ashen or other key aspects of the compensation process. **Thus**, many Committee members certainly could have been better informed concerning a historical perspective on the NYSE.

The smaller NYSE Board created after Grasso resigned should be helpful in addressing this issue. In addition, going forward, close attention should be paid to training new Board and Committee members and providing important historical information to them relating to executive compensation.

F. Grasso's Control Over the People and Processes that Determined His Compensation

Against proper governance practice, Grasso was involved in or connected to the process that determined his own compensation.

He had a strong influence in who was selected as members of the Nominating Committee and the Board, and he personally selected which Board members served on the Compensation Committee. Some directors he selected to serve on the Compensation Committee were those with whom he had or developed friendships or personal relationships. He also selected some of the most prominent CEOs who had large incomes to serve on the Board and the Compensation Committee. All of this at the very least created the potential for conflict of interest and improper influence.

Grasso also determined, in his sole discretion, the "Chairman's Award" component of the annual NYSE performance evaluation process, which the Committee used in part to determine the **annual** bonus awards for NYSE employees generally as well as to benchmark Grasso's own compensation. Grasso knew that the NYSE performance was an important factor in the Board's consideration of his own compensation, and he increased, over the empirical criteria, the performance award each year, which effectively increased the benchmark for his own compensation.

The issues concerning selection of Board members and Committee members have now largely been addressed through the newly revised structure of the NYSE's Board and Compensation Committee. The NYSE should ensure that the Chairman should not in his sole discretion select members of the Compensation Committee that decides his compensation. The Committee also should adopt procedures by which, in the future, the "Chairman's Award" is not used directly to create benchmarks for, or actual awards of, the CEO's compensation.

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Exhibits

**EXCESSIVE ANNUAL
COMPENSATION AND PENSION BENEFIT OF
RICHARD A. GRASSO**

I. Annual Compensation (1995-2002)

Total Paid	<i>Proper</i> Compensation (Per Experts Johnson, Cook and Foley)	<i>Excess</i> Compensation (Per Experts Johnson, Cook and Foley)
\$97,814,582	\$54,683,292	\$43,131,290

II. Pension Benefit (Accumulated Pension as of August 7,2003; Paid Pension as of September 3,2003)

<i>Actual</i> Pension (Accumulated/ Paid)	<i>Proper</i> Pension Per Experts (Accumulated/Paid)		<i>Excess</i> Pension Per Experts (Accumulated/ Paid)	
	Johnson, Cook	Foley	Johnson, Cook	Foley
\$126,386,529/ \$95,100,202	\$12,800,000/ \$12,800,000	\$25,000,000/ \$25,000,000	\$113,586,5291 \$82,300,202	\$101,386,529/ \$70,100,202

**TOTAL EXCESSIVE ANNUAL
COMPENSATION AND ACCUMULATED PENSION**

\$144.5 MILLION TO \$156.7 MILLION

List of Interviews Conducted

NYSE Board of Directors

1. Madeleine K. Albright
2. Herbert M. Allison, Jr.
3. Carol Bartz
4. Charles J. Bocklet, Jr.
5. James E. Cayne
6. James M. Duryea
7. Robert B. Fagenson
8. Laurence D. Fink
9. Richard B. Fisher
10. Richard S. Fuld, Jr.
11. Stanley C. Gault
12. Maurice R. Greenberg
13. William B. Harrison, Jr.
14. James A. Jacobson
15. Andrea Jung
16. **Mel Karmazin**
17. David H. Komansky
18. Kenneth G. Langone
19. Ralph S. Larsen
20. Peter N. Larson
21. Gerald M. Levin
22. H. Carl McCall
23. George C. McNamee

Exhibit 2

24. John J. Mack
25. Reuben Mark
26. Bernard Marcus
27. Lord Colin Marshall
28. Sir Deryck C. Maughan
29. Robert M. Murphy
30. E. Stanley O'Neal
31. Leon E. Panetta
32. Henry M. Paulson, Jr.
33. Philip J. Purcell
34. Christopher C. Quick
35. Juergen E. Schrempp
36. Larry W. Sonsini
37. William B. Summers. Jr.
38. Alex Trotman

NYSE Executives and Staff

39. Frank Z. Ashen, Executive Vice President, Corporate Service
40. Dale B. Bemstein, Vice President, Human Resources
41. Mary Brienza, International **Audit** Group
42. Robert G. Britz, President and Co-Chief Operating Officer
43. Richard M. Dapcic, Internal Audit Group
44. Richard A. Grasso, former Chairman and Chief Executive Officer
45. Keith R. Helsby, Senior Vice President and Chief Financial Officer
46. Alan Holzer, Controller
47. William R. Johnston, Senior Advisor, Office of the Chairman and former NYSE President and Chief Operating Officer

Exhibit 2

48. Catherine R. Kinney, President and Co-Chief Operating Officer
49. Edward A. Kwalwasser, Group Executive Vice President, Regulations
50. Richard L. Ribbentrop, Senior Vice President, Government Relations
51. Darla Stuckey, Corporate Secretary
52. Steve Wheeler, Archivist, Archives and Corporate Research Center
53. Mary Yeager, Assistant Corporate Secretary
54. Robert T. Zito, Executive Vice President, Communications
55. SooJee Lee, Executive Assistant to Richard A. Grasso

Advisors and Consultants

56. Thomas P. Desmond, Partner, Vedder, Price, Kauffman & Kammholz, P.C.
57. Philip Grant, Hewitt Associates LLC
58. Jeffrey S. Hyman, Hewitt Associates LLC
59. Diane Improta, Hewitt Associates LLC
60. Paul W. Larneo, PricewaterhouseCoopers
61. Robert Mischell, Mercer Human Resource Consulting LLC
62. Robert E. Moritz, PricewaterhouseCoopers
63. Robert J. Stucker, President, Vedder, Price, Kaufman & Kammholz, P.C.
64. Ian Lloyd Levin, Proskauer Rose LLP

New York Stock Exchange
Board Of Directors

1995 (As of June 1995)		
Compensation Committee	Other Board Members	
Stanley C. Gault - Chair Richard B. Fisher William R. Johnston Ralph S. Larsen Bernard Marcus Reuben Mark Philip J. Purcell	Paul A. Allaire Geoffrey C. Bible Charles J. Bocklet Jr. J. Gary Burkhead John L. Clendenin Michel A. David-Weill Robert B. Fagenson Benjamin H. Griswold IV Stephan L. Hammerman	A. James Jacoby Edgar Janotta Sr. Sir Colin Marshall Deryck C. Maughan Anthony O'Reilly Michael Robbins Clifton R. Wharton, Jr. Kathryn J. Whitmire
1996 (As of June 1996)		
Compensation Committee	Other Board Members	
Ralph S. Larsen - Chair Richard B. Fisher Richard S. Fuld Jr. Maurice R. Greenberg Bernard Marcus Reuben Mark Deryck C. Maughan	Paul A. Allaire Geoffrey C. Bible Charles J. Bocklet Jr. J. Gary Burkhead Michel A. David-Weill Robert B. Fagenson Benjamin H. Griswold IV Stephan L. Hammerman James A. Jacobson (Beginning September 1996)	A. James Jacoby Edgar Janotta Sr. Sir Colin Marshall Anthony O'Reilly Michael Robbins Alex Trotman Clifton R. Wharton, Jr. Kathryn J. Whitmire
1997 (As of June 1997)		
Comaensation Committee	Other Board Members	
Ralph S. Larsen - Chair Richard S. Fuld Jr. Maurice R. Greenberg James A. Jacobson David H. Komansky Bernard Mar us Reuben Mark Sir Colin Marshall Deryck C. Maughan Alex Trotman	Geoffrey C. Bible Charles J. Bocklet Jr. J. Gary Burkhead Michel A. David-Weill Robert B. Fagenson Richard B. Fisher Benjamin H. Griswold IV A. James Jacoby	Edgar Janotta Sr. Leon E. Panetta Michael Robbins Linda J. Wachner (Beginning September 1997) Clifton R. Wharton Jr. Kathryn J. Whitmire

Exhibit 3

1998(As of June 1998)		
Compensation Committee	Other Board Members	
Bernard Marcus - Chair Robert B. Fagenson Richard B. Fisher Richard S. Fuld Jr. Maurice R. Greenberg David H. Komansky Kenneth G. Langone Sir Colin Marshall Deryck C. Maughan Alex Trotman Linda J. Wachner	Geoffrey C. Bible Charles J. Bocklet Jr. J. Gary Burkhead Stephen M. Case Michel A. David-Weill James M. Duryea Benjamin H. Griswold IV	Gerald M. Levin Robert M. Murphy Leon E. Panetta William B. Summers, Jr. Clifton R. Wharton, Jr. Kathryn J. Whitmire
1999 (As of June 1999)		
Compensation Committee	Other Board Members	
Kenneth G. Langone - Chair Charles J. Bocklet Jr. Richard S. Fuld Jr. Maurice R. Greenberg Mel Karmazin David H. Komansky Sir Colin Marshall Deryck C. Maughan Alex Trotman Linda J. Wachner	Geoffery C. Bible Stephen M. Case Michel A. David-Weill James M. Duryea Gerald M. Levin H. Carl McCall George C. McNamee	Joseph A. Mahoney Robert M. Murphy Leon E. Panetta Henry M. Paulson, Jr. William B. Summers, Jr. Clifton R. Wharton, Jr. Kathryn J. Whitmire
2000 (As of June 2000)		
Compensation Committee	Other Board Members	
Kenneth G. Langone - Chair Charles J. Bocklet Jr. Richard S. Fuld Jr. Maurice R. Greenberg Mel Karmazin David H. Komansky Alex Trotman Linda J. Wachner	Geoffery C. Bible Stephen M. Case Michel A. David-Weill James M. Duryea Peter N. Larson Gerald M. Levin H. Carl McCall George C. McNamee	Joseph A. Mahoney Robert M. Murphy Leon E. Panetta Henry M. Paulson, Jr. Joe L. Roby Juergen E. Schrempp William B. Summers, Jr. Kathryn J. Whitmire

Exhibit 3

2001 (As of June 2001)	7	
Compensation Committee	Other Board Members	
Kenneth G. Langone - Chair Richard S. Fuld Jr. Maurice R. Greenberg Mel Karmazin David H. Komansky Gerald M. Levin Robert M. Murphy Alex Trotman	Michael A. Carpenter James M. Duryea William B. Harrison, Jr. Peter N. Larson H. Carl McCall George C. McNamee Joseph A. Mahoney Jean-Marie Messier	Leon E. Panetta Henry M. Paulson, Jr. Christopher C. Quick Joe L. Roby Juergen E. Schrempp Larry W. Sonsini William B. Summers, Jr.
2002 (As of June 2002)	Board	
Compensation Committee	Other Board Members	
Kenneth G. Langone - Chair James E. Cayne Laurence D. Fink Mel Karmazin David H. Komansky Gerald M. Levin Robert M. Murphy Henry M. Paulson, Jr. Juergen E. Schrempp	Carol Bartz Michael A. Carpenter (Until September 2002) James M. Duryea William B. Harrison, Jr. Peter N. Larson H. Carl McCall George C. McNamee John J. Mack	Joseph A. Mahoney Jean-Marie Messier (Until December 2002) Leon E. Panetta Christopher C. Quick Larry W. Sonsini Martha Stewart (June 2002 - October 2002) William B. Summers, Jr.
2003 (As of June 2003)	Board	
Compensation Committee	Other Board Members	
Kenneth G. Langone - Chair J. Carl McCall - Chair (Beginning July 2003) Herbert M. Allison, Jr. Laurence D. Fink Mel Karmazin Gerald M. Levin Robert M. Murphy Juergen E. Schrempp	Madeline K. Albright Carol Bartz James E. Cayne James M. Duryea Robert B. Fagenson William B. Harrison Jr. Andrea Jung Peter N. Larson H. Carl McCall	George C. McNamee John J. Mack Robert M. Murphy E. Stanley O'Neal Henry M. Paulson, Jr. Philip J. Purcell Christopher C. Quick Larry W. Sonsini William B. Summers, Jr.